

FINANCIAL TIMES

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THURSDAY MARCH 26 1998

Corporate substance
Now business mimics
the grin without the cat
Peter Martin, Page 10

Sweden's military
Is armed neutrality
still necessary?
Page 3

France
Right crumbles
under Le Pen pressure
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Japan's Financial Revolution
Middle East Privatisation
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Mastering Global Business

Around the world in 10 weeks

PART 9: the series
continues tomorrow in a
separate tabloid section



WORLD NEWS

US rethinks policy of taking sanctions against countries trading with Iran

Washington is rethinking its attitude to sanctions against European and Asian companies that invest in Iran's energy sector, said Jim Steinberg, deputy national security adviser. The statement confirmed a new caution in US deliberations on whether to penalise Iran's partners and incur the risk of a transatlantic trade war. Page 12

Iceland wants Canada in Efta
Iceland said it had begun talks with Canada aimed at admitting it to the European Free Trade Association. It is one of the first attempts to include a North American government in a pan-European trading group. Page 3

Italy's employers fight short week
Confindustria, the Italian employers' federation, is to decide tomorrow whether to withdraw from a landmark agreement on incomes policy in response to the government's decision to move towards a 35-hour working week. Page 3

N Ireland talks get deadline
Former US senator George Mitchell, chairman of the Northern Ireland talks, set the first explicit target date, April 9, to bring the peace process to "a swift and favourable conclusion". Page 7

Clinton voices sorrow in Rwanda
Touring US president Bill Clinton met maimed survivors of Rwanda's 1994 genocide and acknowledged the world had not done enough to stop it. Page 6; Lex, Page 12

Liberals hold Nova Scotia
Canada's Liberal party appeared to have survived the Nova Scotia election, retaining the right to govern the Atlantic province with only 18 seats in the 52-seat legislature - tied with the New Democratic party. Page 5

United pressure on Milosevic
Russia joined western countries in insisting that Yugoslav president Slobodan Milosevic make an urgent start to autonomy talks with the Albanians of Kosovo. Page 3

US envoy weighs Middle East
US envoy Dennis Ross is to arrive in the Middle East today to assess whether the time is right for the US to put forward proposals to kick-start Israeli-Palestinian talks. Page 6

Hong Kong fights another flu
Hong Kong faced another health scare as a lethal "Sydney flu" strain of influenza was suspected of killing two men in their 60s and leaving a child critically ill.

Gains expected in Indonesia talks
Bankers said talks today on renegotiating more than \$80bn of Indonesian private offshore debt were expected to narrow down to two proposals that might end months of deadlock. Page 4

Argentina moves to end amnesty
Argentina's lower house of Congress voted to repeal laws granting amnesty to perpetrators of human rights abuses during the military dictatorship of 1976-83. Page 4

TV ads aimed at soccer thugs
The UK government launched a TV campaign aimed at keeping soccer hooligans away from the World Cup competition in France. Page 7

BUSINESS NEWS

SocGen to set up film finance unit in London for European films

Société Générale, the French banking group, today launches a London-based film financing division to take advantage of the revival of the European film industry. Page 13; Link-up with Russell, Page 15

Recent rises in US stocks
have sparked fresh debate about share price valuations, and whether the US market is trading at dangerously high levels. Page 13; Lex, Page 12

SAP shares fall after the German
software group repeated its warning that growth would slow and outlined a "virtual stock" plan to help it retain employees. Stocks closed DM4 lower at DM791 (\$432.24). Page 16

The EU has appealed against a WTO
judgment that Britain and Ireland breached rules by reclassifying computer equipment to higher-tariff categories. The complaint was brought by the US. Page 6

News Corporation, the media group,
has been excluded from the Australian market for terrestrial digital television broadcasting for at least another decade. Page 4

Norika Skog, one of Europe's
biggest newspaper producers, has signed a letter of intent to acquire a stake in Thailand's only newspaper mill, Shin Ho Paper. Page 18

Banques Populaires, the French
co-operative banking group, rescued Paris-based business bank Natexis in a friendly takeover worth FF77bn (\$1.14bn). Page 16

Skandinaviska Enskilda Banken,
the Swedish bank, has bought a stake in Sampo, Finland's largest insurer, from Swedish-Finnish bank MeritaNordbanken. Page 18

EasyJet, the low-cost UK airline,
will announce today that it has bought a 40 per cent stake in TEA Switzerland, a Swiss charter carrier with four leased Boeing 737s. Page 21

Telefonica, the Spanish telecoms
group, plans to raise Ptas600bn (\$3.87bn) in new capital, signalling an aggressive phase of acquisition activity in Latin America. Page 13

Singapore launched the biggest
convertible bond out of Asia with a \$1bn issue exchangeable into shares of Singapore Telecom. Page 13; Bonds, Page 22

Leading aluminium companies
are to make a second attempt to acquire Venezuela's troubled aluminium complex, one of the world's largest, under new conditions. Page 20

Argentaria, the privatised Spanish
banking group, plans to merge its main units to realise latent capital gains and reduce costs. Page 15

INA, Italy's second largest insurance
group, is looking for a partner to help develop a new residential and commercial property company. Page 15

World Equity Markets

The latest trends and data from more than 50 national markets at a glance
Page 33

Russia plans to dismiss 200,000 state employees

Minister insists IMF-supported \$6.7bn
austerity programme will go forward

By Chrysis Ireland in Moscow

The Russian government plans to sack more than 200,000 state employees and slash Rb40bn (\$8.7bn) from its spending commitments as part of a radical austerity programme aimed at bolstering the country's shaky public finances, a minister said yesterday.

The move comes in the wake of Russian president Boris Yeltsin's dismissal of the entire government this week. But Alexei Kudrin, deputy minister of finance, insisted political uncertainty would not slow the cost-cutting drive.

Mr Kudrin, one of the main authors of the austerity programme, said the drastic job cuts, including 68,000 teachers and 22,000 medical staff, were part of a sweeping plan to sack 10-15 per cent of the federal government's employees.

Mr Yeltsin has asked his officials to propose a new government next week, but the finance ministry is expected to remain largely intact.

The restructuring drive is likely to have an immediate effect on millions of Russians as the federal government pushes ahead with the dismissals over the next three or four months.

The redundancies are part of a programme agreed with the International Monetary Fund, known as the Kudrin-Fischer plan, to reduce government expenditure.

Mr Kudrin told the Financial Times that the finance ministry had already targeted 208,000 jobs, ranging from bureaucrats to doctors.

He expected the overall number of redundancies this year to be even higher. So far only half of Russia's vast state machinery has fallen under the finance ministry's scrutiny.

Over the next month equally deep job cuts would be made in the remaining areas.

Mr Kudrin indicated that the mass job cuts and sharp reduction in government spending commitments were not at odds with Mr Yeltsin's demand this week that the cabinet focus more on social issues and on improving the lot of the average Russian.

He said the cuts would brighten the national mood by ensuring the government had enough cash to pay the employees who remained on its payroll.

"Everyone else will be paid on time and the social tension will decrease," he said.

The radical redundancy programme would mean a chaotic shift of much of Russia's vast state-supported social welfare net into the private sector.

The government austerity drive came at a time of continued uncertainty over the fate of Anatoly Chubais, the former first deputy prime minister who was once seen as Russia's foremost reformer but was fired this week.

Mr Kudrin, a Chubais protégé, said yesterday afternoon that the government would nominate Mr Chubais to become chairman of the board of Unified Energy Systems, the national power company, a post that would make the ousted minister one of the most influential people in the Russian economy.

But by yesterday evening, Mr Chubais appeared to have lost political momentum. Instead, Boris Berezov, the widely respected former commercial banker who is running UES, said he would stay.

VW opens battle for Rolls-Royce Motors

By Graham Bowley in Wolfsburg, Roger Taylor in London and William Lewis in New York

The battle for control of Rolls-Royce Motor Cars began in earnest yesterday when Volkswagen of Germany became the first group to make a public bid for the UK luxury carmaker.

Its move came as a second potential bid, involving Daimler Benz, appeared to have stalled. Daimler has repeatedly denied it would bid for Rolls-Royce. However, it had been working on a joint bid with Goldman Sachs under which it would have taken a minority stake, with Goldman committing its own funds to take a majority holding. The plan has now been ditched.

Ferdinand Piëch, VW chairman, revealed that Europe's biggest carmaker had submitted its bid for Rolls-Royce to Vickers, its parent company, on Tuesday afternoon. He refused to give details about the price offered.

Vickers shares rose 7 1/2 to 233p. The spotlight will now fall on BMW, the German carmaker which has been considered the favourite to take over Rolls-Royce from Vickers. It has links with Rolls-Royce and supplies the engines for the new Silver Seraph model.

BMW confirmed the company still planned to bid. "BMW will put a bid in at the appropriate time," the company said.

Speculation continues about other possible bidders. Doughty Hanson, the private capital group, is believed to be preparing a bid. In addition, two groups of Rolls-Royce enthusiasts are working on offers. One, involving Kevin Morley, the for-

mer director of Rover, is thought already to have put in a bid. The other, headed by Michael Shrimpton, a lawyer, is planning to make its offer next week.

Daimler Benz's absence from the auction will come as a blow to Vickers' hopes of generating competition between the three big German car groups.

Vickers is looking to raise over £300m (\$500m) from the sale although early indications are that initial bids could be as low as £250m - a price thought unacceptable to Vickers. Bernd Pischke, BMW chairman, has said BMW would not "overbid".

VW's bid underlines Mr Piëch's ambitions to expand VW's car range into the upper luxury vehicle sector. He said yesterday this would happen irrespective of the outcome of the Rolls-Royce bid and that VW would consider creating its own luxury brands if the bid failed.

Robert Büchelhof, the board member who is overseeing VW's bid, said: "We want to be in the top segments of the automotive world. We are convinced that buying Rolls-Royce and Bentley [Rolls-Royce's sister marque] would be a very interesting and attractive way of moving into the top segment."

The bidding process is expected to continue for several weeks. Vickers hopes to get initial bids in over the next week and a half and will then allow all the bidders involved time to consider raising their offers before narrowing the field.

New horizons, Page 16
Lex, Page 12

EUROPEAN BANKING CHIEF WARNS ITALY AND BELGIUM OVER EMU MEMBERSHIP



Pause for thought: Wim Duisenberg, president of the Emu, at yesterday's news conference. Picture Reuters

Brussels backs 11 countries for single currency in 1999

By Wolfgang Münchau and Andrew Fisher in Frankfurt and Lionel Barber in Brussels

The European Commission yesterday formally recommended that 11 European countries should adopt a single currency from 1999, but central bankers issued a sharp warning that Italy and Belgium had not done enough to reduce their debt.

In its report on economic convergence, the European Monetary Institute, the forerunner of the European Central Bank, expressed "ongoing concern" that the two countries had made insufficient progress to reduce their debt ratio of over 120 per cent of gross domestic product to an agreed target of 60 per cent.

Wim Duisenberg, president of the Emu, said the criticism was not at odds with the Commission's recommendation that the two countries qualify for economic and monetary union.

All European Union member states bar the UK, Denmark, Sweden and Greece are expected to join Emu next year.

If, as expected, EU leaders follow the Commission's recommendation, the single currency zone will contain almost 300m people

and account for 18.4 per cent of world GDP and 18.6 per cent of world trade.

Mr Duisenberg yesterday hinted that a report from the Bundesbank, the German central bank, on Friday, would closely follow the Emu's line, given that the Bundesbank president Hans Tietmeyer will have signed both documents.

Mr Duisenberg's comment was seen as a warning to the Germans not to deviate from the finely calibrated judgment that allows Italy and Belgium to qualify for the single currency, the euro, in spite of reservations over their debt levels.

Yves-Thibault de Silguy, EU monetary affairs commissioner, rejected accusations that countries had used accounting gimmicks to manipulate the budget deficit figures to meet the 1997 target of 3 per cent of GDP.

The French and German employers' federations welcomed yesterday's reports. In a joint statement they said that if Emu was to succeed in the long run, members had to reform tax and welfare systems.

The Commission also issued new forecasts predicting an aver-

age 2.8 per cent growth in 1998 for all members of the EU and 3.0 per cent in 1999, up from 2.7 per cent in 1997.

They have been shaved to take account of the Asian financial crisis and slower than expected growth in Germany.

But a recovery should lead to the creation of 3.4 million jobs between 1997 and 1997 as the EU economy generates domestic rather than export-led growth, the Commission said.

Jacques Santer, president of the European Commission, urged EU leaders to break the deadlock over who should head the European Central Bank before May 2, when they formally choose the founder members of Emu.

"We must not let the job become hostage to a personal quarrel," he said - a reference to President Chirac's opposition to Mr Duisenberg. Mr Duisenberg acknowledged yesterday that the row might already have damaged the credibility of the ECB.

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WORLD MARKETS

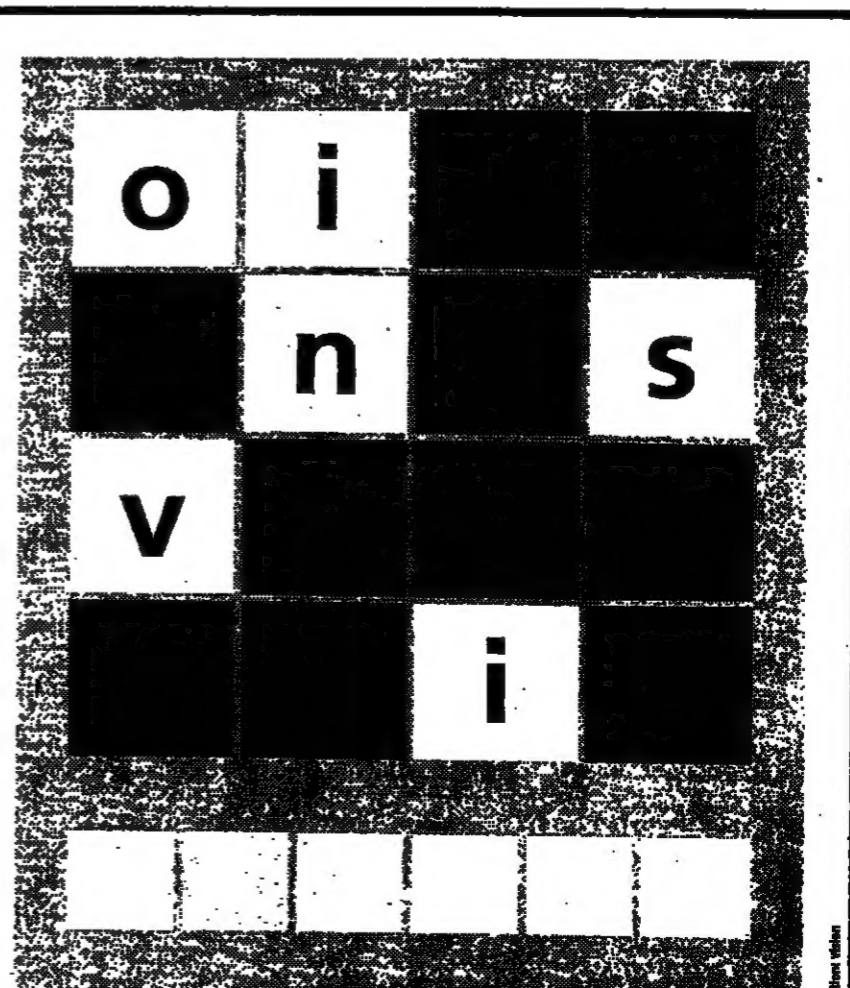
STOCK MARKET INDICES		
New York: Dow Jones	8,942.3	(+37.88)
NASDAQ Composite	1,635.98	(+23.54)
Europe and Far East		
London: FTSE 100	5,082.62	(+68.28)
Nikkei	15,857.8	(+115.9)
Hong Kong: Hang Seng	10,029.34	(+61.89)
COMMODITY PRICES		
Oil: Brent	15.77	(+0.01)
Gold: London	328.25	(+0.01)
CURRENCY RATES		
US dollar: London	1.6747	(+0.0001)
Japanese yen: London	163.25	(+0.01)
Swiss franc: London	1.4913	(+0.0001)
Deutsche mark: London	1.3664	(+0.0001)
French franc: London	6.5596	(+0.0001)
Italian lira: London	1,936.27	(+0.01)
Spanish peseta: London	166.64	(+0.01)
Portuguese escudo: London	200.48	(+0.01)
Irish punt: London	0.7875	(+0.0001)
Scottish pound: London	1.6667	(+0.0001)
Malaysian ringgit: London	2.3363	(+0.0001)
Singapore dollar: London	1.3664	(+0.0001)
Thai baht: London	54.83	(+0.01)
Indonesian rupiah: London	1,587.5	(+0.01)
Philippine peso: London	48.15	(+0.01)
Malaysian ringgit: London	2.3363	(+0.0001)
Singapore dollar: London	1.3664	(+0.0001)
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WORLD NEWS

EUROPE

LIFT-OFF FOR THE EURO THE COUNTDOWN STARTS

Keeping up the pace in the Emu race

By Andrew Fisher in Frankfurt

European countries have made strenuous efforts to negotiate the hurdles on the way to monetary union, but will they be able to keep up the pace? That is the question at the heart of the final convergence report of the European Monetary Institute - soon to be upgraded to the European Central Bank - and the answer has yet to become clear.

The Emi clearly has its doubts, though it did not express them so strongly as to exclude the more shaky potential members of European monetary union. In fact, Wim Duisenberg, the Emi's president, said he did not think there were any arguments in its report that went against the European Commission's recommendation that 11 of the 15 EU states should join at the start.

But while the Emi was gratified that "major improvements in terms of convergence" had been recorded since its last such

report in November, 1996, it made it very clear that these must be continued.

In some countries, notably Italy, Belgium and Greece, the pace of fiscal progress needed to be accelerated considerably. All three have debt ratios of more than 100 per cent of gross domestic product against the Maastricht treaty requirement of 60 per cent.

The institute stressed its "ongoing concern" about whether progress towards meeting the Maastricht criteria could be sustained in these countries once Emu was under way next year. But when asked whether this meant that Belgium and Italy had failed to fulfil the criteria - Greece does not qualify for the first wave of entrants - Mr Duisenberg replied: "No, it does not mean that."

What it did mean was that countries bringing their debt ratios down from above 100 per cent "will have to demonstrate sustained efforts to continue that process in a significant way."

Even European Union states with less alarming debt ratios needed to redouble their efforts. The Emi noted that the average debt ratio in the EU was still around 72 per cent.

Moreover, the fall in deficit ratios below the Maastricht level of 3 per cent of GDP and the decline in debt ratios had only occurred recently in many countries. Some of these reductions stemmed partly from one-off measures, though the institute did not single out any of these.

It said that "within the context of a single monetary policy, the adjustments seen over the recent past need to be carried substantively further."

In most countries, "decisive and sustained corrective policies of a structural nature" were warranted. This was because of high and persistent unemployment (largely structural), the future pensions burden from an ageing population, and high public debt levels which would weigh on some

Europe converges

European Commission forecasts for 1998

Ireland
Real GDP growth (%) 8.7
Deficit/surplus (% of GDP) +1.1
Debt (% of GDP) 89.5

Belgium
Real GDP growth (%) 2.8
Deficit/surplus (% of GDP) -1.7
Debt (% of GDP) 118.1

Luxembourg
Real GDP growth (%) 4.4
Deficit/surplus (% of GDP) +1.0
Debt (% of GDP) 7.1

Portugal
Real GDP growth (%) 4.8
Deficit/surplus (% of GDP) -2.2
Debt (% of GDP) 69.8

Spain
Real GDP growth (%) 3.5
Deficit/surplus (% of GDP) -2.2
Debt (% of GDP) 67.4

France
Real GDP growth (%) 3.8
Deficit/surplus (% of GDP) -2.9
Debt (% of GDP) 58.1

Italy
Real GDP growth (%) 2.4
Deficit/surplus (% of GDP) -2.5
Debt (% of GDP) 118.1

Greece
Real GDP growth (%) 3.8
Deficit/surplus (% of GDP) -2.2
Debt (% of GDP) 167.7

UK
Real GDP growth (%) 1.9
Deficit/surplus (% of GDP) -0.6
Debt (% of GDP) 52.3

Netherlands
Real GDP growth (%) 3.7
Deficit/surplus (% of GDP) -1.8
Debt (% of GDP) 70.0

Finland
Real GDP growth (%) 4.6
Deficit/surplus (% of GDP) +0.3
Debt (% of GDP) 53.6

Sweden
Real GDP growth (%) 2.8
Deficit/surplus (% of GDP) +0.5
Debt (% of GDP) 74.1

Denmark
Real GDP growth (%) 2.7
Deficit/surplus (% of GDP) +1.1
Debt (% of GDP) 89.5

Germany
Real GDP growth (%) 2.6
Deficit/surplus (% of GDP) -2.5
Debt (% of GDP) 61.2

Austria
Real GDP growth (%) 2.8
Deficit/surplus (% of GDP) -2.3
Debt (% of GDP) 64.7

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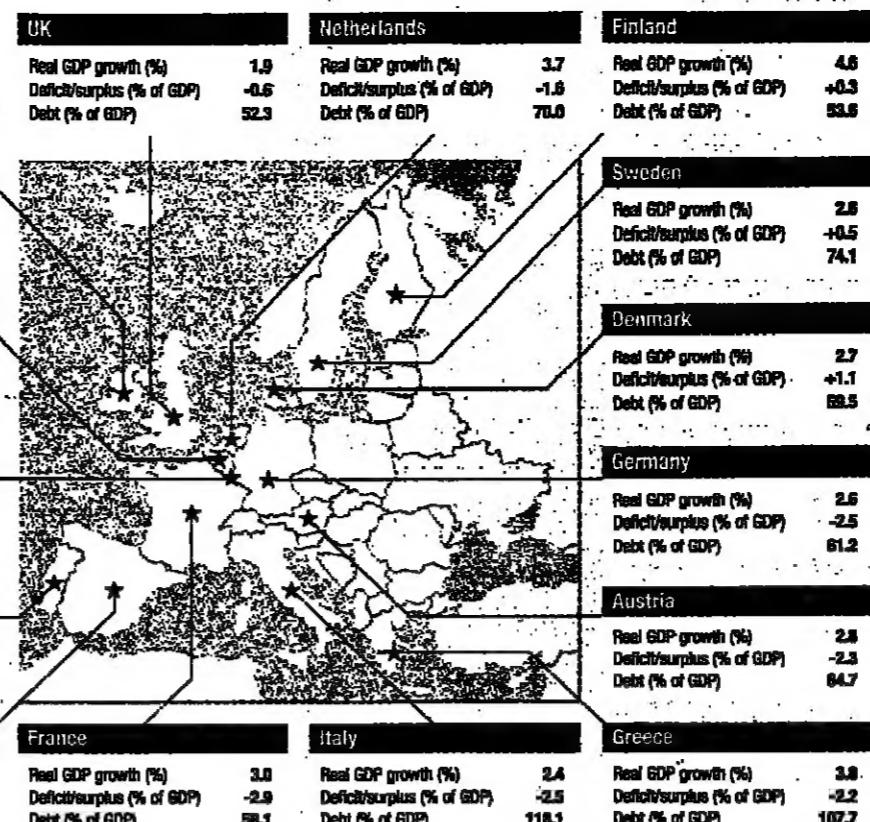
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budgets until the debts were reduced. In the case of Belgium, which last year had a debt ratio of 123 per cent - though its deficit ratio was

only 2.1 per cent - the Emi said there was "evident ongoing concern" as to whether this would come down swiftly enough. The term "ongoing concern" was

also used for Italy and Greece. However, there were also strictures for Germany and France, which both needed to bring down their deficit

ratios further in order to ease the debt burden. Even those countries in the front of the pack cannot rest on their laurels.

The report also warned against the danger of backsliding at home. "The Netherlands is, according to recent figures, the only member state where the deficit in 1996 - in spite of relatively powerful economic growth - is expected to rise somewhat."

This meant that the "favourable cyclical conditions are therefore not being utilised to speed up the deficit reduction, so that there is little or no room below the deficit ceiling of 3 per cent to absorb setbacks." The Dutch public deficit stood at 1.4 per cent of gross domestic product last year.

The bank has criticised the expansionary budget measures implemented by the government ahead of the general election on May 6. Nout Wellink, the governor, has been maintaining the admonitory tone often adopted by Wim Duisenberg, his predecessor.

Wim Kok, the prime minister, preferred to focus on Italy in his immediate reaction to the reports by the central bank, the European Commission and Mr Duisenberg's European Monetary Institute. "Italy has substantial problems with its public debt and its deficit," he said. "It remains to be seen whether the Italian parliament will provide the necessary support."

The European Commission gave a more upbeat assessment of the state of French public finances. It said France's 1998 budget was "a clear indication of the government's commitment to budgetary consolidation" and concluded: "An excessive deficit no longer exists in France."

enhance competition in product markets and to improve the workings of the labour markets. The European Commission gave a more upbeat assessment of the state of French public finances. It said France's 1998 budget was "a clear indication of the government's commitment to budgetary consolidation" and concluded: "An excessive deficit no longer exists in France."

removed a taboo about its political legitimacy and Mr Megret has dangled before the voters a seemingly reasonable six-point programme of regional government. Until now the strength of the moderate right has been the illegitimacy of the NF and the residual legacy of General de Gaulle's nationalist populism. They have also been helped by a two-round, first-past-the-post voting system in general elections that has excluded the front (it has one deputy but 15 per cent of the national vote). These strengths have been squandered as the RPR and the UDF have been converted into personal fiefdoms at the expense of a coherent programme of government.

"An era has come to an end," Francois Bayrou, chairman of the UDF parliamentary group, said as his party gathered to consider

the fate of the five rebels. "We now have to build a new political party of the centre, centre-right."

Talk of bringing the RPR and UDF under one roof has become more urgent, though not necessarily more probable. There are too many egos with personal agendas and too much suspicion attaches to the ambiguous role of President Chirac. He founded the RPR as the heir to the Gaullist heritage and is now keen to form a new grouping that would reinforce his ambitions to stay on in the presidency.

However, the head of state cannot easily be the effective head of the opposition without straining "co-habitation" with the Socialist government. He came close to partisanship this week in a TV address whose prime motive appeared to be a desperate attempt to rescue his friends in the moderate right.



Le Pen (right) with the 'reasonable' Megret Pierre Restier

wants to bring his party into the mainstream and is not tarred with the same overt anti-semitism and virulent nationalism as the founder-leader Jean-Marie Le Pen. Even if the dissidents now

recant and resign, the divisions have been too obvious and the disobedience too long not to undermine the credibility of the moderate right. At the same time the flirtation with the NF has

removed a taboo about its political legitimacy and Mr Megret has dangled before the voters a seemingly reasonable six-point programme of regional government. Until now the strength of the moderate right has been the illegitimacy of the NF and the residual legacy of General de Gaulle's nationalist populism. They have also been helped by a two-round, first-past-the-post voting system in general elections that has excluded the front (it has one deputy but 15 per cent of the national vote). These strengths have been squandered as the RPR and the UDF have been converted into personal fiefdoms at the expense of a coherent programme of government.

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ITALY PUBLIC SPENDING WORRY

Fiscal surpluses needed 'rapidly'

The European Commission praises Italy's "far-reaching" budget consolidation, writes Lionel Barber. The public deficit has fallen from 9.5 per cent of gross domestic product in 1993 to 2.7 per cent in 1997. One-off measures such as last year's partly refundable euro-tax helped, but Brussels says that pension reform and longer-term changes in taxation and the state budget.

The effect is likely to be neutral in 1998 but consequences in the medium-term are "potentially significant". Nevertheless, the single largest contribution to deficit reduction was lower interest rates, says the Commission.

The Emi report expresses concern about the high level of government debt, which is more than twice the Maastricht level of 60 per cent of GDP. It says "the need to bring down the debt ratio by around 3 percentage points of GDP per year. This would allow Rome to hit the goal of a government debt of 100 per cent of GDP by 2003."

The government has also announced its intention to bring down the debt ratio by around 3 percentage points of GDP per year. This would allow Rome to hit the goal of a government debt of 100 per cent of GDP by 2003.

marked ageing of the population which - in the context of an unfunded public pension system - could raise public spending as a proportion of GDP.

The Commission says Italy meets the debt criterion because the downward trend is more important than the actual level of debt. Brussels singles out Italy's strong primary surplus - the budget surplus before debt repayments - which was 4.8 per cent of GDP in 1997 and suggests that debt reduction will "accelerate" in 1998 and in future years.

The sale of state-owned agencies has bolstered receipts and is expected to continue to raise between 0.5 and 0.75 per cent of GDP per year.

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The effect is likely to be neutral in 1998 but consequences in the medium-term are "potentially significant". Nevertheless, the single largest contribution to deficit reduction was lower interest rates, says the Commission.

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GERMANY THE UNIFICATION FACTOR

Tax shortfalls and ageing population

Without the financial burden of unification, Germany would have sailed through the Emu convergence criteria with little difficulty, writes Andrew Fisher. As it is, the country meets most of the criteria comfortably.

But in the past seven years, its ratio of government debt to gross domestic product has risen sharply - from 41.5 per cent in 1991, well within the Maastricht

limit of 60 per cent, to 61.3 per cent in 1997. This year, it is likely to ease to 61.2 per cent.

"Without inclusion of unification-related liabilities, the German debt ratio would have remained well below the 60 per cent of GDP reference value," says the European Commission.

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NEWS DIGEST

CAPITAL ADEQUACY REQUIREMENTS

Estonia aims to check current account deficit

Estonia's central bank said yesterday it was considering measures aimed at slowing economic growth and checking the spiralling current account deficit, which it said hit 13 per cent of gross domestic product last year.

In 1996, the deficit stood at 9.5 per cent. According to preliminary figures, the economy grew by 9 per cent in 1997. Strong domestic demand and a dynamic domestic financial sector stoked up the current account deficit.

Peter Lohmus, central bank vice-president, said the method of calculating commercial banks' capital adequacy requirements might be changed. This would effectively raise the capital adequacy requirement above the current 10 per cent, and force commercial banks to curtail lending. The central bank previously raised capital adequacy requirements from 8 per cent last October.

In the past year Estonia's commercial banks have had access to foreign credit at favourable international rates. This foreign borrowing has fuelled domestic consumption, contributing to the growing gap in the current account. In a press release, the central bank also suggested the government might take further fiscal measures to slow economic growth. *Mette Vipotnik, Tallinn*

SLOVAK PRESIDENCY

Meciar attacked on powers

The Slovak opposition yesterday began a public campaign against the prime minister's assumption of presidential powers. Vladimir Meciar took on most of these at the start of this month when the president stepped down without a successor in place.

A large rally in Bratislava on the tenth anniversary of a demonstration against the communist regime launched a petition demanding that the president's powers be temporarily vested in parliament. It also called for the president to be directly elected on subsequent occasions, rather than being chosen by parliament.

Parliament has made two attempts to elect a candidate with the required three-fifths majority. On April 16, it will make a third attempt. So far the only candidate is Brigita Schmögnerová, the deputy leader of the former Communist party of the Democratic Left.

The government, which has enough votes to block a candidate but not to impose one, has yet to put forward a nominee, although Mr Meciar has toyed with the idea of standing himself. *Robert Anderson*

UKRAINE ELECTIONS

Tatars may get voting rights

In an effort to defuse unrest around parliamentary elections next Sunday, President Leonid Kuchma of Ukraine is likely to grant voting rights to members of an ethnic minority who do not have Ukrainian citizenship, a presidential aide said yesterday.

Mr Kuchma's advisers are drafting a decree that would allow about 20,000 Crimean Tatars to take part in the elections, the aide said.

Crimean Tatar demonstrators clashed with police in the semi-autonomous Crimean region on Tuesday after the Ukrainian parliament in Kiev rejected legislation that would have allowed some 100,000 of their number who are not citizens of Ukraine to vote. Tatar leaders said they would urge Mr Kuchma to resolve the issue before the elections for the national parliament, the Crimean parliament and local bodies. Some warned of violence if the problem remained unresolved.

Soviet dictator Josef Stalin exiled the Crimean Tatars en masse to Central Asia in 1944. Since the late 1980s, more than 250,000 members of the Moslem minority have returned to Crimea. They make up about 10 per cent of the Black Sea peninsula's population. *AP, Kiev*

TURKISH POLLS

Reforms first, says Ecevit

Turkey's deputy prime minister, Bulent Ecevit, said yesterday the government wanted to push through reforms before considering the option of early polls sought by a key opposition leftist. "If early elections are seen as necessary, the date for them should only be discussed after parliament has passed reforms," Mr Ecevit told a meeting of his Democratic Left party. "We do not want early elections but we do not fear them either."

A tax reform bill, passed by a parliamentary commission last week, is awaiting debate in the general assembly. Another draft law to reform Turkey's crumbling social security system is being held up by the government's leftist critics.

Deniz Baykal, a leftist opposition power-broker, on Tuesday called for polls in the autumn in a speech rekindling speculation that elections would be held before they are due in 2000.

Turkish financial markets have been weighed down in recent sessions by fears of early polls and a row between the military and the conservative-led government over how to combat Islamist activism. *Reuters, Ankara*

VATICAN-POLAND RELATIONS

Pope hails new treaty

Pope John Paul yesterday hailed a new treaty between the Vatican and Poland which governs relations between the Polish state and the Roman Catholic Church. "We had to wait for this for 53 years," the pope said after a ceremony in which Jerzy Buzek, Poland's prime minister, and Cardinal Józef Glemp, the Vatican's secretary of state, formalised a concordat.

The concordat was passed early this year by Poland's parliament, which is dominated by centre-right groups. About 90 per cent of Poland's population belong to the Catholic Church, at least nominally.

"One cannot forget the system of totalitarian government in Poland when our nation was subjected to many humiliations, many wrongs and limitations of freedoms," the pope said in a speech to the Polish and Vatican delegations.

The passage of the concordat followed a Church-backed decision by the centre-right majority in Poland's parliament late last year to restore tough restrictions on abortion, which had been eased by the previous leftist administration.

Among other provisions, the treaty makes church marriages legally binding and provides for religious classes starting from kindergarten. *Reuters, Vatican City*

PAPON TRIAL

Wife's death delays verdict

The judge in the trial of the accused Nazi collaborator Maurice Papon adjourned the proceedings yesterday for five days after the death of the defendant's wife of 65 years. Mr Papon's lawyers said a verdict in the nearly six-month-long trial was now expected next Wednesday. Before the delay, a verdict had been due late tomorrow.

Paulette Papon, 88, died of cancer during the night at the couple's home in Gritz-Argemont, a suburb east of Paris.

The main defence lawyer, Jean-Marc Vassaut, began his closing statement on Tuesday, arguing that the charges against his client were "in shreds" and that the trial was a farce aimed at exorcising France's second world war guilt.

Mr Papon, who served as Paris police chief and budget minister after the war, is accused of ordering the arrest for deportation of 1,580 Jews in 1942-1944 when he was secretary-general of the Bordeaux region prefect's office and supervisor of its Service for Jewish Questions. *Reuters, Bordeaux*

Milosevic pressed on Kosovo dialogue

By Peter Norman in Bonn

Leading western countries and Russia insisted yesterday that Slobodan Milosevic, the Yugoslav president, make an urgent start to unconditional dialogue with leaders of the Albanian community of Kosovo on greater autonomy for the Serbian province.

Warning that they would keep up sanctions and apply further measures in four weeks' time if necessary, the foreign ministers of the Contact Group - the US, Russia, Germany, France, Britain and Italy - said they expected Mr Milosevic to take "personal responsibility for ensuring that Belgrade

engages in serious negotiations on Kosovo's status".

Madeleine Albright, the US secretary of state, who chaired the group, said the timing of yesterday's talks, two weeks after a previous Contact Group meeting in London, was a measure of the danger of the crisis in Kosovo. About 80 ethnic Albanians, including women and children, have been killed during the Serbian crackdown of recent weeks.

Mrs Albright told the meeting that Mr Milosevic had been "bobbing and weaving" in response to international pressure to commit himself to a solution in the province, where 90 per cent of the 2m population

are ethnic Albanians. Progress, she said, would be achieved only by sustained pressure. "If we settle for half measures, all we will get are half measures."

She said also Mr Milosevic had not done enough to meet demands made in London. "We decided to focus all our diplomatic efforts on promoting an immediate start to dialogue," she said. Mr Milosevic "must embrace dialogue publicly, enter it without preconditions, accept outside participation and take political responsibility for making it work".

Robin Cook, the UK foreign secretary, made clear sanctions would include a freeze on foreign assets of



Ethnic Albanians survey a destroyed house yesterday after clashes with Serbian police. Picture Reuters

the Yugoslav and Serbian governments if no progress was made in the next four weeks.

Yesterday's negotiations were difficult. It was with reluctance that Russia joined the other five countries in agreeing to imple-

ment credit and visa sanctions announced on March 9 and to seek adoption by March 31 of a United Nations arms embargo on rump Yugoslavia, which comprises Serbia and Montenegro. Mrs Albright admitted the US would have liked more

from yesterday's talks. "We are moving gradually but unmistakably forward in the direction of greater pressure on Belgrade," she said. "We have sustained the minimum degree of pressure needed to move the process forward."

Austrians oppose EU enlargement

By Eric Frey in Vienna

On the eve of the European Union membership negotiations with five east European countries and Cyprus, polls show that a majority of Austrians oppose the enlargement of the EU.

Worries focus on competition from low-wage workers and cheap products, as well as an immigration wave and rising crime rates on the borders to Slovenia, Hungary and the Czech Republic are opened.

According to a Eurobarometer poll issued this month,

a majority of Austrians would deny EU membership for four of the five applicant countries from eastern Europe. Hungary was the only country whose membership most Austrians would favour.

This broadly negative sentiment goes against the coalition government's position on enlargement as well as indications that the Austrian economy benefited handsomely from the opening of eastern borders after 1989. Last year, the trade deficit shrank by 32 per cent from the previous year

largely because of exports to eastern Europe.

The negative sentiment also surprises Austria's EU partners and Brussels officials, who often consider enlargement as a pet project by Germany and Austria.

"I find the excitement in Austria strange because the advantages of the opening to the east have already arrived, through excellent export figures and accelerating growth," said Monika Wulz-Mathies, EU regional commissioner.

But popular opinion identifies the east mostly as a

threat to prosperity and personal safety. This also reflects continued scepticism about the consequences of Austria's EU membership and fears of economic globalisation. "There is too much happening at once, at least that's the way the people see it," said Franz Fischler, the EU agricultural commissioner and an Austrian.

The main foe of EU enlargement is Jörg Haider, the populist leader of the far-right Freedom party. He warns of a wholesale destruction of jobs, economic turmoil and he has managed

to put the government on the defensive.

Mr Haider hopes to make enlargement the top campaign issue for the next parliamentary elections in 1999.

Austria's government, which combines Social Democrats and the conservative People's party, argues against rushing the enlargement process.

Austria also wants long transition periods on the free movement of labour and recently asked the European Commission for a special subsidy program for its eastern borders enlargement.

Canada in talks on Efta entry

By Tim Burt in Reykjavik

The government of Iceland yesterday said it had begun talks with Canada aimed at admitting the country to the European Free Trade Association, one of the first attempts to include a North American government in a pan-European trading group.

David Oddsson, the Icelandic prime minister, said the negotiations would be more far-reaching and would be completed sooner than separate discussions between the European Union and the Canadian authorities.

The Icelandic government, which currently chairs Efta, indicated that any agreement would seek to abolish or sharply reduce trade tariffs and import quotas between Canada and Efta.

Officials from Ottawa yesterday met Icelandic counterparts in Reykjavik, amid suggestions an outline deal could be signed next year. Although Efta only represents Switzerland, Norway, Iceland and Liechtenstein, Canada hopes a deal could become a model for other trade accords in Europe.

Mr Oddsson, in an interview with the Financial Times, said such an agreement would help Iceland to develop trade ties outside the EU. "We see ourselves in a favourable position, being able to use Efta and the European Economic Area as a gateway to the EU, without needing to apply for EU membership."

Mr Oddsson said that Iceland could not contemplate joining the EU while the common fisheries policy remained in place. Although the policy is due to be revised in 2002, the prime minister said Iceland would remain an unlikely candidate for EU enlargement.

"Even if the fisheries policy was replaced with something more sensible, it would be impossible for this country to surrender control of monetary and economic policy," he added. According to Icelandic officials, the country's self-imposed fisheries quota system - with a limited catch allocated to every vessel - had proved more effective than an EU system involving incentives to decommission vessels. Iceland relies on fish and marine products for about 80 per cent of its exports and almost one quarter of gross domestic product.

Swedes try to cut cost of defending neutrality

As the threat of external attack dwindles, the military establishment is worrying about its budget, writes Tim Burt

Army officers in Sweden explain the country's high level of military readiness and defence spending with a simple slogan: "För Kung och Fosterland" - for king and fatherland.

With more than 3,000km of coastline to protect and air-space stretching from the Arctic to the Baltic, they see no contradiction between the kingdom's long-standing neutral and non-aligned status and the preservation of large conscript forces and a national arms industry.

Last week, however, the Swedish government signalled for the first time that the strategy could prove unsustainable in the dying years of the 20th century.

Announcing the findings of a long-awaited defence review, Björn von Sydow, the country's defence minister, said that the government would be seeking savings in the armed forces budget of Skr2bn (\$250m) a year over the next five years.

The move, aimed at curbing a projected Skr10.5bn overspend by military chiefs, follows a 10 per cent reduction last year in the Skr40bn defence budget.

Owe Wilkström, supreme commander of the armed forces, has warned that the cuts could weaken Sweden's ability to defend itself from attack. Skirting the fact that Sweden has not fought a war since 1814, he claimed such cuts could be tolerated only temporarily.

The government, anxious not to alienate the armed forces or create unemployment among arms manufacturers, has come up with a solution designed to pacify

the military and industrial hierarchy.

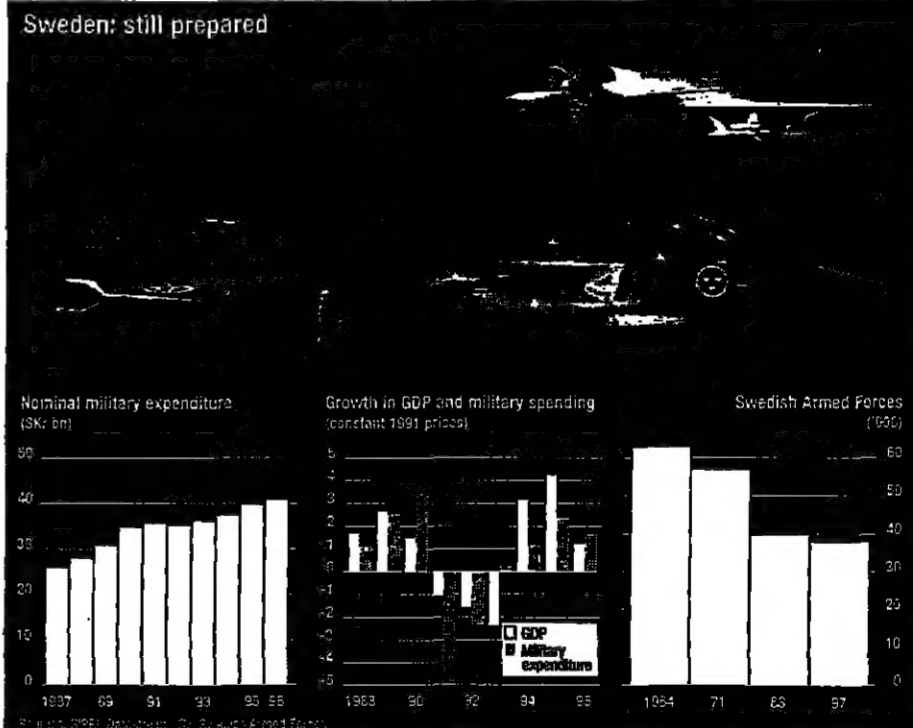
Mr von Sydow, in an interview with the Financial Times, said that costs could be cut in procurement, training and force numbers by extending the 12-month mobilisation period which has been the cornerstone of Sweden's defence strategy. "I will put a bill before parliament that will extend the time needed to achieve full military capability."

Although western defence strategists might regard a 12-month mobilisation as somewhat tardy in an age of rapid response forces, Mr von Sydow argued that Sweden can afford to downgrade its readiness because the threat from across the Baltic Sea has diminished markedly.

Put simply, defence officials believe that the country can afford to "stand easy" because its potential attackers - were there any - are woefully ill-prepared themselves. Although they do not mention it, Sweden as a target does not have the strategic attractions of its Nordic neighbours Norway, with its vast oil reserves, or Denmark's land frontier with Germany.

That, however, has not soothed arms manufacturers which employ about 20,000 people in Sweden. Celsius, the company which owns the Bofors defence business, has predicted that 1,000 jobs could be lost. Kockums, Sweden's submarine producer, has voiced concerns. And industry analysts have estimated that up to 5,000 jobs in total may be sacrificed.

Mr von Sydow believes those fears are groundless. He pointed out that such



companies not only survived but expanded after defence cuts in the 1980s, and that they could help fill any excess capacity at home by seeking orders overseas.

The government has been an active supporter of such export drives, particularly for the Saab-Les 39 Gripen fighter jet programme, jointly marketed with British Aerospace.

According to the defence minister, further export-oriented co-operation projects could protect Swedish interests in the inevitable rationalisation of Europe's defence industry.

In future, Mr von Sydow said companies such as Saab could carve out a niche role by exploiting assets such as missile and space technology.

"One thing is clear, we cannot continue with the

national production system used between the 1940s and 1980s. The industry has to modernise."

That means becoming more cost-efficient, accepting overseas ownership if necessary and investing more in new technology. By doing so, manufacturers could retain a sizeable share of the defence budget.

Certainly, Mr von Sydow has made clear he favours buying state-of-the-art hardware - albeit with orders spread over a longer period and more options than firm contracts.

At the same time, he outlined plans that could involve a reduction in conscription. Experiments with three-month and 60-day training programmes could be extended, promising lower manpower costs while maintaining the national tra-

dition of conscription.

Mr von Sydow predicted that the programme would enable Sweden to strike a balance between maintaining a high technology defence industry and continuing with a conscription programme designed to "create the capability for resistance within the population."

If that can be done at a lower cost, then the government will have shown that countries such as Sweden - or neighbouring Finland - can retain effective military forces in Europe, while remaining outside Nato and ostensibly neutral.

"There is no pressure on us to take part in Nato enlargement and no reason to do so," said Mr von Sydow. "We have gone our own way before and we are ready to do it again."

Decision day on threat to Italian pay accord

By James Blitz in Rome

Confindustria, the Italian employers' federation, will decide tomorrow whether to back out of its threat to abandon the accord.

"The government has liquidated the system of round-table negotiations which, over the last five years, has made a substantial contribution to improving the credibility of the country and reforming the public finances," the organisation said on Tuesday night after the cabinet took the critical step of placing the legislation before parliament.

The unions have warned that a decision to abandon the 1993 accord would have a severe impact on industrial relations. "I hope that inside Confindustria calm and good sense can prevail because a renunciation of the 1993 accord would mark a clean

break with the trade union movement," said Sergio Cofferati, the general secretary of the Cgil union.

The stand-off is the result of an accord reached between Romano Prodi's government and Reconstructed Communism, the small far-left party, under which a 35-hour week would be introduced in order to keep Mr Prodi in power.

One positive note for the government in recent days has been the moderately successful outcome of talks between the government and the trade unions over the future of the south.

Although the unions are yet to declare themselves satisfied by the measures being taken by the government, they have abandoned plans to hold a general strike pending a new round of discussions before Easter.

One week before Poland is due to start membership negotiations with the European Union, President Aleksander Kwasniewski has accused the government of being behind with preparations for the talks.

Similar fears have been expressed by sources close to the European Commission, who say the accession talks could be prolonged by a continuing failure to co-ordinate policy inside the government. The talks are at present expected to last a minimum of two years.

Mr Kwasniewski, a former communist who was elected in 1995, presides in French-style "cohabitation" with a centre-right coalition government. The Solidarity Electoral Action (AWS), the gov-

Poland 'unprepared' for talks with Brussels

By Christopher Bobinski in Warsaw

ernment's senior partner, was elected last autumn on a fiercely anti-communist programme. Jerzy Buzek, the prime minister from the AWS, has denied that Poland is ill-prepared for the talks, which start next Tuesday.

Mr Kwasniewski has complained that Poland's negotiating documents are not yet complete and charged that the "last month has been lost". He also wants to be consulted more on the preparations for the talks and to work with the government as the negotiations proceed.

Concern also appears to be mounting inside the European Commission that the Committee for European Integration (KIE), the Polish government department responsible for co-ordinating the EU membership effort, is failing to perform its duties. The KIE is headed by

Ryszard Czarnecki, a member of the rightwing nationalist ZChN movement, which is a member of the AWS alliance. Since the new government came in last November, the KIE has failed to present a single proposal for spending EU aid funds on adapting Polish institutions to EU procedures. The EU sources note that lengthening delays in implementing aid projects could jeopardise Poland's chances of gaining access to pre-accession funds in coming years.

Brussels is also becoming increasingly bemused by a lack of co-ordination. For example, Jacek Janiszewski, the agriculture minister, is calling for rapid Polish access to the EU's farm support regime, while Mr Buzek has said that Polish farming will need long transition periods to adapt.

THE AMERICAS

US plans customer choice in electricity

By Bruce Clark in Washington

The Clinton administration yesterday unveiled a long-awaited plan for the electricity industry which would allow customers to choose their own supplier by 2003, except where state governments opt out.

The plan, which cuts a middle path between a host of competing proposals for the sector's future, also calls for a surcharge on electricity that would create a \$3bn fund aimed at promoting

energy efficiency, conservation and aid for low-income consumers. Most of the plan would require action from Congress, which is regarded as very unlikely to pass a comprehensive bill on the electricity sector this year.

The blueprint would leave state governments to decide the issue of stranded costs: whether or not utilities can pass on to consumers the cost of past investments, especially in nuclear power, which have been rendered uneconomic by competition.

Administration officials said the plan would save the average family of four some \$222 per year, by spurring electricity providers to make use of cheaper technologies and cut retail prices. It would also cut the emission of heat-trapping greenhouse gases by 25m to 40m tonnes by 2010 - by increasing the pressure on electricity producers to use new natural gas-based technologies which are environmentally benign as well as cheaper than coal.

But the plan does not call for any formal curbs on greenhouse gas emissions which environmental campaigners would like to see. The proposal was unveiled by Federico Peña, the energy secretary, and Carol Browner, the administrator of the Environmental Protection Agency.

But industry experts said it was questionable whether those two officials could overcome the reluctance of Congress to take radical action over electricity,

unless President Bill Clinton or Vice-President Al Gore become personally involved in lobbying legislators.

The most Congress is likely to do this year is abolish a law that restricts the freedom of utilities to diversify, expand and raise capital - a minimalist agenda that is favoured by parts of the industry, but regarded as far too little by advocates of reforming the sector.

Yesterday's proposal would increase the power of the Federal Energy Regula-

tory Commission to prevent large utilities from obtaining a dominant position, and to ensure the reliability of the national grid. The influential utilities lobby is expected to insist that the current, voluntary approach to maintaining reliability should be kept in place.

But the proposal includes a concession to the older, established utilities by allowing state governments to opt out of the plan to mandate retail competition in five years' time.

Smoking incurs \$130bn costs

By Mark Suzman in Washington

Tobacco-related illnesses cost the US economy \$130bn a year through medical care and lost productivity, according to a Treasury study.

The report says that meeting targets for cutting smoking in the proposed national tobacco settlement would generate an annual economic gain of \$78bn within 10 years.

Lawrence Summers, deputy Treasury secretary, yesterday said investment of \$780bn at a rate of return of 10 per cent would be required to produce the same overall gain - more than the US annual corporate investment in machinery and equipment.

"Nearly \$80bn per year that our economy would have lost with those lives [damaged by smoking] can instead be used to add to their lives and the lives of other Americans," he said.

He urged Congress to approve the multi-billion dollar deal. "The stakes are high, the right path is clear." Although the new estimates are controversial - for example they do not take into account medical savings from premature deaths or sales generated by the industry - they will add to pressure on Congress to act on the settlement during the current legislative session.

After vacillating on the issue for several months, the White House has thrown its weight behind achieving a tobacco deal this year, partly because it has already budgeted for extra revenue from the deal.

John McCain, chairman of the Senate commerce committee, is working on bipartisan legislation, but several key issues, including the size of payments which tobacco companies would be required to pay, remain unresolved.

According to the Treasury study, smoking-related illnesses cost \$45bn a year, while economic losses resulting from premature retirements and deaths of productive workers are as high as \$80bn.

Combined with costs of about \$4bn a year because of foetal deaths and health problems caused by smoking during pregnancy, \$500m in fire damage caused by smokers and a \$4bn smoking-derived premium in life insurance purchases for non-smokers, total economic costs are more than \$130bn annually.

Mr Summers said the comprehensive programme for reducing youth smoking envisaged by the settlement - which would combine steep price rises and tough restrictions on marketing and advertising - would reduce smoking by 60 per cent over 10 years.

Argentina takes step closer to repeal of amnesty laws

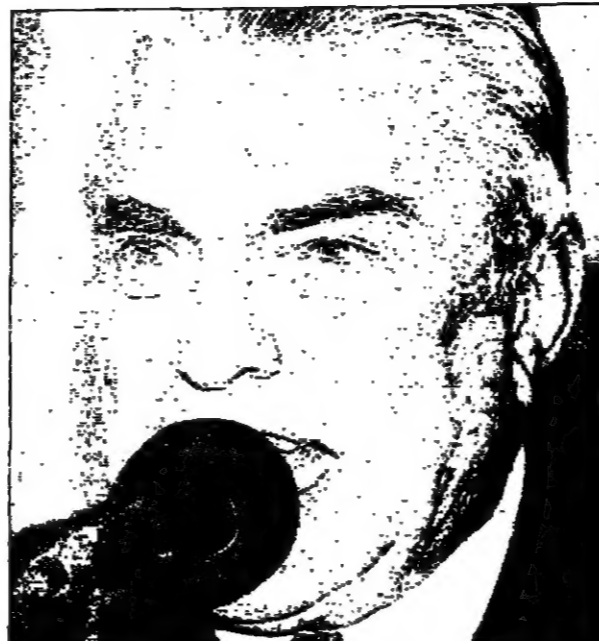
By Ken Warr in Buenos Aires

Argentina's lower house of Congress has voted to repeal laws granting amnesty to the perpetrators of human rights abuses during the 1976-83 military dictatorship, which killed as many as 30,000 of its political opponents.

In a rare act of political consensus, deputies from the ruling Peronist party and the opposition Alliance combined on Tuesday night and voted to strike down the laws. The repeal must be approved by the Senate and could yet be vetoed by President Carlos Menem.

However, the vote is a move towards legal normality and has raised the hopes of human rights campaigners that more information will come to light about the fate of the "disappeared" in a truth commission due to be set up soon. Human rights groups estimate some 30,000 people were killed during the military's "dirty war" against its political opponents and 15,000 cases have been documented.

The "Full Stop" and "Due Obedience" laws were passed by the civilian government of President Raúl Alfonsín in 1986 and 1987 in an effort to cool continued military unrest. They halted fresh prosecutions of the military and shielded junior officers from prosecution on



Antonio Bussi: fighting for political survival

the grounds that they were obeying orders. Mr Menem pardoned convicted officers and jailed leftwing guerrillas in 1989 and 1990.

Repeal of the laws, if ratified, will not be retrospective and is unlikely to open the way to renewed human rights abuse trials. However, it would put a halt to the Due Obedience defence in future cases of human rights violations. The vote was a "step forward," said Carlos "Chacho" Alvarez, one of the

Alliance's co-leaders.

The halting of prosecutions and lack of information over the fate of the "disappeared" continue to convulse Argentina. Tuesday's vote coincided with protests to mark the 22nd anniversary of the coup which toppled the government of Isabel Perón and brought the military to power.

Angered by the bar on trials of the military, campaigners have taken to harrying former members of the

regime, demonstrating outside their homes and daubing the walls with slogans.

Investigators are also examining the possibility of prosecuting former members of the military regime for economic crimes, such as seizing their victims' assets. Baltasar Garçon, a Spanish judge investigating the fate of 600 Spanish citizens who disappeared during the "dirty war," has detected a series of Swiss bank accounts belonging to former regime members.

Former General Antonio Bussi, the governor of Tucumán Province both under military rule and again now, is fighting for political survival after admitting to possessing an undeclared Swiss bank account. Mr Bussi was sanctioned by a military tribunal last week for not declaring the account.

Judge Garçon's investigation has infuriated Argentina's government, which questions his jurisdiction outside Spain, and led to tensions with Madrid. "Crimes should be judged where they occurred," said Raúl Granillo Ocampo, justice minister, last week.

Mr Menem has made repeated calls for national reconciliation over the "dirty war," during which he himself was imprisoned. However, earlier this month he sprang to the defence of the armed forces.

NEWS DIGEST

MEXICAN BUDGET

Decision to cut spending wins widespread praise

Mexican businessmen and economists yesterday applauded the government's decision to cut spending for the second time this year in response to falling oil revenues. Late on Tuesday, José Ángel Gurría, finance minister, announced he would trim 1998 expenditures by 9bn pesos (\$1.06bn), or 1 per cent of the 1998 budget, to prevent expansion of the fiscal deficit. Mr Gurría said the new "preventive adjustment" was in addition to 15.3bn pesos slashed from the budget in January. Mr Gurría said the spending cuts would affect infrastructure projects in the state-owned oil and electricity sectors, but not Mexico's projected economic growth of 5 per cent this year. The fiscal deficit target of 1.25 per cent of gross domestic product was unchanged.

Oil exports are the single biggest revenue source for the Mexican government, accounting for between 30 and 40 per cent of the government's income. Mr Gurría said the government was recalculating oil income for the rest of the year based on an average price of \$12.5 a barrel for the basket of Mexico's light and heavy crudes. This compares with oil price estimates of \$13.5 in January and \$15.5 in December. Leslie Crawford, Mexico City

US DURABLE GOODS

Orders fall 1.7% in February

Orders for US durable goods fell by 1.7 per cent to \$184bn during February, the US Commerce Department said yesterday, but economists remained optimistic about the pace of the US economy. Although the fall in durable orders was more than expected, most of the decline was due to the volatile aircraft sector. Excluding transport, orders rose by 0.5 per cent from January, the third consecutive monthly increase.

Most analysts blamed falling demand from Asia, but they also said the crisis had contained mortgage rates, which drove the pace of home sales to record levels last month. The National Association of Realtors said sales of existing homes rose 8.7 per cent in February to a seasonally adjusted annual rate of 4.75m, up from 4.37m in January.

Defence orders, led by aircraft, declined sharply by 27.8 per cent. Non-defence orders slipped by only 0.6 per cent. Excluding aircraft, non-defence orders rose 1.3 per cent in February, after even large gains in December and January. Transport equipment, down in two of the last three months, recorded the largest decline - falling \$3.8bn, or 8.5 per cent, to \$41.6bn. However, the decline in the aircraft sector was more than offset by an increase in vehicles and parts. Nancy Dunne, Washington

NOVA SCOTIA ELECTION

Narrow win for Liberals

Canada's Liberal party appears to have survived a leftwing threat in Nova Scotia's election, retaining the right to govern the Atlantic province but only by the slimmest margin possible. The majority Liberal government of Russell MacLellan, the provincial premier, was reduced to just 19 seats in the 52 seat legislature, tying with the left-leaning New Democratic party. As the incumbent party, the Liberals will form the next government, but they could quickly be defeated by a non-confidence vote. Nova Scotia Liberals, who held 39 seats in the previous government, have seen their popularity eroded by five years of spending cuts, particularly in health care and education. The national Liberal party, which has also cut spending, fared poorly in the region during last year's federal election. Scott Morrison, Toronto

ASIA-PACIFIC

Property prices dip in Japan for 7th year

By Gillian Tett in Tokyo

Real estate prices have fallen in Japan for the seventh consecutive year, a key government survey showed yesterday.

The National Land Agency's annual report on listed land prices showed that prices for commercial properties in big metropolitan areas fell 7.5 per cent in the year to January 1998, compared with an 11.5 per cent fall in the previous year.

Notionwide, commercial property prices fell 6.1 per cent, compared with 7.8 per cent the previous year.

Residential land prices in big metropolitan areas fell 2.5 per cent, compared with a fall of 2.8 per cent the previous year.

And nationwide, residential prices fell 1.4 per cent, compared with 1.6 per cent the previous year.

The NLA survey was conducted in January this year. The report, which surveys so-called "listed land prices", is used as a benchmark for public and private land transactions and for government assessment of inheritance and property taxes.

The NLA yesterday pointed out that the annual rate of decline was now easing compared with the early 1990s. However, it admitted that the fall in residential real estate prices appeared to accelerate in the second half of the year.

This fall represents a blow for the Japanese government, which had hoped that the decline in property prices since the collapse of the 1980s bubble was finally ending. Land prices are playing a particularly crucial role in the Japanese economy at present because the banks hold a large amount of property-related bad loans. Consequently, if property prices fall, this makes it harder for banks to write off their bad loans.

India's fiscal position 'worse than expected'

By Mark Nicholson in New Delhi

Yashwant Sinha, India's new finance minister, told an unruly parliament yesterday he had inherited a "significantly worse" fiscal position than expected, revealing a fiscal deficit for this year of 6.1 per cent of gross domestic product against the target of 4.5 per cent set by the former United Front government.

Mr Sinha, in office for less than a week in the government led by the Bharatiya Janata party (BJP), was presenting an interim budget to tide over government finances for the first quarter of the next fiscal year.

starting on April 1. As an interim budget, the minister could only carry over existing tax structures - which he said currently implied an estimated fiscal gap next year of 6 per cent of GDP.

However, Mr Sinha said he would present a full budget "in a few weeks" which would aim to cut the implied deficit while also stimulating India's flagging economy. He also said "economic reforms will be deepened, broadened and accelerated".

Mr Sinha sketched a gloomy picture, saying GDP growth for the fiscal year ending this month had slowed to 5 per cent, resulting from a 2 per cent fall in

agricultural output and sluggish industrial growth of 4.6 per cent for the 12 months to January. He said exports had posted negative growth in dollar terms for the three months to January.

The fiscal gap he blamed chiefly on "major shortfalls" in tax receipts, which were 12.6 per cent down on the budget estimates made last February by P. Chidambaram, his predecessor.

However, the cause lay in lower customs and excise receipts, due to slow imports and sluggish industrial production, rather than in lower direct tax receipts. Mr Chidambaram's budget aggressively cut both

income and corporate taxes.

Casting expenditure and revenue into next year based on present tax rates, Mr Sinha said the government would incur a fiscal gap of 6 per cent of GDP, which he said was "not acceptable".

His budget would aim to cut this to a "reasonable limit", though the scale of the task was indicated by the fact that 39 per cent of the foreseen rise in government expenditure for next year lay in a Rs103bn (\$2.6bn) rise in interest costs.

Without elaborating in a short speech, Mr Sinha said his budget would seek to stimulate agriculture and industry, revive exports,

encourage bigger foreign investment flows - subject to the BJP alliance's stated reservations - and take "decisive initiatives" to improve infrastructure.

Mr Sinha's speech was delayed by more than an hour as G.M. Balayogi, the newly elected and controversial BJP-backed choice as speaker of parliament, struggled to control unruly opposition MPs, many of whom walked out to protest at the new government's handling of relief for Tuesday's typhoon in West Bengal.

The uproar, which left Mr Balayogi repeatedly pleading "please, this is not good, this is not good" with the book of

parliamentary rules open before him, boded ill for the BJP alliance's prospects of managing its slim parliamentary majority.

The government tomorrow faces a formal confidence vote, which it is expected to win.

Earlier, K.R. Narayanan, the president, had formally opened parliament with an introductory address outlining the new government's objectives, which laid heavy emphasis on improved social programmes to alleviate hunger, homelessness, illiteracy and unemployment. It also promised heavier spending on agriculture and infrastructure.

Australian TV blow to Murdoch

By Owen Robinson in Sydney

News Corporation, Rupert Murdoch's media group, has been excluded from the Australian market for terrestrial digital television broadcasting for at least another decade.

The Australian government has decided to give the country's three commercial television broadcasters and two public broadcasters exclusive rights for 10 years to begin free digital TV broadcasting.

The government ruled out the prospect of a fourth and fifth commercial TV network

before 2008, effectively barring pay-TV operators and other potential rivals, such as Mr Murdoch's News Corp. Australia is the second big digital TV market from which Mr Murdoch has been excluded. Last year British regulators insisted that British Sky Broadcasting, in which News Corp has a 40 per cent stake, dispose of its stake in British Digital Broadcasting, which holds three licences for digital terrestrial broadcasting in the UK.

Australian consumer groups and political opposition leaders yesterday criticised the government's decision. They accused the government of giving the commercial broadcasters free rein to exploit Australia's fledgling digital broadcasting technologies. Consumer groups warned the decision could lead to monopolisation of information content supply by existing broadcasters.

The new digital framework, announced on Tuesday, was a blow to Mr Murdoch, who has led combined efforts by the country's pay-TV operators to persuade the government to auction off the entire digital spectrum.

In a bitter year-long battle over the issue, Mr Murdoch forged a strong alliance with his rivals in the pay-TV industry against the three commercial broadcasters.

The government also decided to open up spare capacity on the new digital spectrum to other communications companies, as well as the three commercial broadcasters, for the provision of data services, including online advertising and electronic commerce.

Under the plan, companies will be able to bid in competitive auction for spectrum to provide such data services.

Malaysia acts to strengthen financial sector

By Sheila McNulty in Kuala Lumpur

Malaysia's central bank announced decisions yesterday to strengthen financial institutions and increase transparency, but observers noted they came too late to help the country through its biggest crisis in a decade.

In releasing Bank Negara Malaysia's annual report, central bank governor Ahmad Mohd Don signalled that the authorities thought the impact of the regional crisis on Malaysia was not severe enough to warrant big structural adjustments at this time.

Economists hoped Malaysia would follow neighbours in using the crisis to liberalise foreign participation and make the economy more competitive. Mr Ahmad insisted the restrictions would remain but added it was difficult to anticipate what might happen in the months ahead.

The central bank is raising the minimum capital funds for finance companies from M\$5m to M\$600m (US\$1.37m to US\$164m) by the end of 2000, reducing the limit on single customer exposure

from 30 per cent to 25 per cent of total capital; requiring banking institutions to publish data on key indicators every quarter; and raising the minimum risk-weighted capital ratio requirement for finance companies from 8 per cent to 10 per cent by the end of 1999.

Economists were pleased that Mr Ahmad left open the possibility of a worsening situation and supported his vow to keep monetary policy tight despite hints by the authorities of a possible loosening. "They're moving in the right direction," said Neil Saker, head of regional economic research at SocGen-Crosby.

Mr Ahmad declined to project how high the ratio of non-performing loans will rise from 8.7 per cent at the end of February. Economists suspect 20 per cent. Mr Ahmad further indicated the central bank would not be able to consolidate the finance companies as much as it had hoped and, indeed, the government was extending a one-year guarantee against further reduction in value of the acquired assets to instil confidence in acquiring institutions.

Fuel oil supplier seeks N Korea cash

By Peter Montagnon, Asia Editor, in London

Kedo, the international consortium which is installing safe nuclear power in North Korea, has debts of \$47m and is running out of money to supply heavy fuel oil while the plant is being built. Paul Cleveland, its US director said.

The US, a founder member of Kedo along with the governments of South Korea and Japan, is seeking additional contributions from Europe to help make up the shortfall. Without additional funds, the shipments of oil will stop "in the not too distant future", he said.

It is important to keep the oil flowing, he said, because North Korea had lived up to its commitment under the \$5.2bn project to freeze its nuclear programme that allowed it to produce weapons grade plutonium. "We're on the lip of a terrible plunge if North Korea were to deliver, and we were not."

The US was seeking an additional \$3m a year from Europe, bringing its annual contribution to around \$26m, but it was itself prepared to increase its contributions to the fuel oil purchases and contribute \$16m to paying off the outstanding debt. Japan and South Korea were being asked to pay off the balance.

The anxiety over fuel oil shipments comes as Kedo is locked in more complex negotiations over how to cover the capital cost of the project. South Korea has agreed to contribute 70 per cent of the total cost and Japan about \$1bn but that leaves roughly \$500m uncovered.

While Japan and South Korea are anxious about starting to contribute this money without a solution, the US wants to avoid delays. The US could manage to put up only a small amount of the extra \$500m, Mr Cleveland said.

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WORLD TRADE

Brussels set for climbdown over BSE

By Michael Smith in Brussels

The European Commission yesterday prepared for a climbdown over BSE, or "mad cow" disease, by signalling it was close to abandoning its fight for an early ban on potentially infectious animal parts.

The European Union's executive stance means an EU-enforced ban on so-called "specified risk materials" in some countries from next

January is extremely unlikely.

There are increasing doubts whether a ban will ever be implemented.

This will please the US, which has argued the proposed ban on "specified risk materials" was unnecessary and would have severely disrupted trade.

However, it will dismay consumer groups which have argued for the ban on animal parts, including

brains and spinal cords, on the grounds that they are at risk of carrying BSE.

The Commission said yesterday it would make a final attempt tomorrow to establish an EU regime on specified risk materials. It considered "these measures essential to achieve a high level of consumer protection from the risk of BSE".

The "last ditch" attempt will be made at a meeting of EU country representatives

who will be asked to amend a July 1997 ban proposal which the Commission has the authority to implement.

It seems likely to fail since the suggested changes have already been rejected by farm ministers.

The Commission conceded yesterday that the July 1997 proposal, due to come into force on April 1, "cannot apply as it stands" because of the emergence of new scientific evidence and because

of the problems it would cause to the supply of essential life-saving pharmaceuticals.

The threat to pharmaceutical supplies, which contain products made from animal parts, is one of the reasons the US has opposed the ban.

The Commission had not intended to disrupt trade in pharmaceuticals or a range of industrial goods which contain products

made from cattle parts.

But some countries saw their chance to block a ban they opposed by refusing to accept changes to the July 1997 proposals. The Commission said yesterday that if countries refused to accept amendments tomorrow it would withdraw its July 1997 proposal.

It added that it would then submit a new proposal with the aim of achieving a long-term solution.

NEWS DIGEST

JAPANESE CAR EXPORTS

Tokyo says Brussels has agreed to higher quota

Japan and the European Union yesterday agreed to raise Japan's 1998 quota for car exports to the EU, according to Japan's Ministry of International Trade and Industry. Officials from the two sides have been meeting in Tokyo since Monday to set this year's quota levels under a voluntary export monitoring system set up in 1993 and due to expire at the end of 1998.

The ministry official said the quota was increased to 1,167,000 vehicles, up 53,000 from last year, primarily reflecting an expected rise in EU demand. Another factor, he said, was Japanese carmakers' plans this year to introduce new models in the European market. The agreement does not cover Japanese vehicles made in the EU. Several Japanese carmakers have set their sights on the European market, with Toyota aiming to boost local production and increase overall sales in Europe by more than 10 per cent this year. Reuters, Tokyo

TELECOM MERGERS

Acquisitions at record \$17bn

Global cross-border merger and acquisition activity in the telecommunications sector reached a record \$17bn last year as leading companies sought to expand their overseas operations. This was an increase of 15 per cent on the previous year, according to a report by KPMG, the accounting group. European telecom groups accounted for \$10.2bn of the acquiring activity, with North American groups second on \$2.9bn.

The \$1.8bn purchase of a 25 per cent stake in Syntelnet by a consortium of investors, including George Soros, was the biggest deal of 1997. Other highlights included China Telecom's \$1.2bn acquisition of a 5 per cent stake in Hong Kong Telecom, and the \$900m purchase of VTR of Chile by Telefonos de Spain.

"The buying spree is being fuelled by the trend towards consolidation and globalisation in the sector worldwide, and by the large number of opportunities for market entry arising from privatisation and liberalisation," said KPMG. The firm predicted a further increase this year. Christopher Price, London

ISRAELI STEEL

Importers to fight duties

Israel's steel importers yesterday said they would appeal against the imposition of import duties on Israeli steel. The industry complains imposed a 21 per cent tariff, the equivalent of between \$12 and \$22 a tonne which steel importers and EU diplomats said was against the spirit of free trade. They also denied dumping allegations.

The local steel production industry is dominated by United Steel Mills, a subsidiary of Koor Industries, and Yehuda Placid, a subsidiary of Discount Investment Corporation. They have lobbied the trade and industry ministry to impose import tariffs in a bid to keep out competitors which would reduce the price of steel. The average price of a tonne of steel in Israel is \$31,240 (\$344).

Last year, demand for steel totalled 700,000 tonnes of which 240,000 is imported. During the 1990s, Italian and Spanish steel was imported, but due to high transport and labour costs importers switched to Turkish steel. The committee's ruling was directed against Italian steel imports which are almost negligible. But Andre Valda, joint managing director of Hod Metal Products and Manufacturing Company, a leading producer of metal wire products, said the ruling could serve as a precedent for duties on Turkish steel. Judy Dempsey, Jerusalem

Brussels renews anti-dumping cotton duties

By Neil Buckley in Brussels

The European Commission has imposed provisional anti-dumping duties on imports of unbleached cotton from six Asian countries for the second time in two years - in defiance of opposition from a majority of European Union states.

The measures were welcomed by Eurocotton, the textile weavers' association which brought the dumping complaint. But they provoked anger among the countries affected and various trade groups including those representing textile importers and finishers who say their segment of the industry will be damaged by the controversial duties.

The 20 European commissioners decided yesterday, without discussion, to impose duties with a base level of 15.7 per cent on China, 20.6 per cent on Egypt, 16.9 per cent on Indonesia (31.7 per cent), Pakistan (28.5 per cent) and Turkey (14.2 per cent).

The move came in spite of a 9-5 vote against the measures, with one abstention, in an advisory committee of EU states' representatives.

Brussels can impose provisional duties for six months without a vote by EU ministers, though it must consult the advisory committee - whose vote it rarely over-

rules. Ministers must vote to convert provisional duties into definitive five-year duties within six months; otherwise they lapse. This is the second time the Commission has imposed provisional measures. A first set of duties were removed after ministers voted 9-4 against them last May in spite of intervention in favour of the measures by President Jacques Chirac of France.

Brussels opened a new inquiry into the case last summer, despite complaints from free trade groups that this represented unfair harassment of the countries affected.

The Commission said yesterday its move to impose duties was consistent with the findings of its investigation that all six countries had been involved in dumping which damaged EU industry.

Michèle Anselme, secretary-general of Eurocotton, said the Commission's investigation had been carried out "objectively and thoroughly". She was confident ministers would back the measures in six months.

But the British Apparel and Textile Federation called the move "incomprehensible". John Wilson, director-general, said: "Member states have clearly indicated their unhappiness at the proposals."

MEXICO TELECOMS

Talks on connection fees open

By Henry Tricks in Mexico City

Mexico has brought forward talks on telephone interconnection rates following complaints that current levels are stifling foreign telecoms business in Mexico.

Carlos Casasús, head of the Federal Telecommunications Commission (Cofetel), said the talks, scheduled to begin in June, were already under way. Even this year's rates were under discussion, he said.

Interconnection fees, which Telmex, the domestic telecoms operator, charges long-distance competitors to complete calls locally, are a key part of Telmex's revenues.

A main rival, Avantel, claims Telmex has the world's highest intercon-

nection rates, at around 7 US cents a minute. MCI, Avantel's US partner, earlier this year suspended a \$800m investment programme in Mexico, saying 70 per cent of Avantel's revenues were drained by interconnection costs. Telmex disputes that.

"The negotiations have already begun," Mr Casasús said. "It's very likely that we could have negotiations between the different sides that affect interconnection rates this year in exchange for different conditions next year."

Mr Casasús has previously argued that this year's rates were spelled out in 1996 and would not be changed. But pressure has been exerted by Telmex's long-distance rivals, especially US carriers AT&T and MCI which have

sought to block Telmex's access into the US.

Mr Casasús also said that separate talks were under way between Telmex and US authorities on the international settlement rates charged to US carriers to complete international long-distance calls in Mexico.

William Kennard, chairman of the US Federal Communications Commission, last month called the rates "inflated" and criticised lack of competition in Mexico.

That dealt a blow to Telmex's hopes of getting final FCC approval for entry to the US long-distance market, even though Mexico has opened its market to powerful US competitors.

The complaints about the state of competition in

Mexico were partly borne out last week when Mexico's anti-trust Competition Commission ruled that Telmex was a "dominant carrier", or monopoly, which exposes it to tighter regulation than before.

The decision was hailed by Telmex's competitors, some of which have complained that it has received benign treatment from regulators. "It's going to provide Cofetel with a much broader set of tools with which to regulate Telmex," said Bob Lacey, Avantel's vice-president of regulatory affairs.

But Mr Casasús sought to dampen expectations of the impact of the decision. The main effect requires Telmex to provide a breakdown of its accounting in different markets.

EU challenges ruling on tariffs

By Frances Williams in Geneva

The European Union has appealed against a World Trade Organisation panel judgment that Britain and Ireland breached WTO rules by reclassifying computer equipment to a higher category for telecoms devices.

The complaint, brought by the US, involves some \$2.5bn of US exports of Local Area Network (LAN) adapter equipment, making it one of the most important cases in commercial terms heard by the world trade body.

The panel said the two countries had violated WTO rules by shifting LAN equipment from a low-tariff classification covering computer equipment to a higher category for telecoms devices. The US says it is concerned to ensure that the WTO's Information Technology Agreement, which will eliminate tariffs on high-tech goods by the year 2000, cannot be undermined by reclassifications. The EU says the reclassification is consistent

with WTO rules.

The appeal was notified just before a meeting of the WTO's dispute settlement body which had been due to adopt the panel report. It yesterday set up panels to hear complaints on Canadian dairy subsidies by the US and New Zealand, and by the EU against what it alleges are discriminatory taxes on imported liquor imposed by Chile. Chile changed its liquor tax legislation in response to an earlier EU complaint but Brussels says it is still not

satisfied. Canada and the US are third parties in the dispute, along with Peru.

Meanwhile, the US and five Latin American countries complained yesterday that proposals to change the EU's banana import regime appeared inconsistent with WTO rules. The WTO has given the EU until January to change its banana import policies.

However, EU ministers have not yet agreed on modifications proposed by the European Commission.

INTERNATIONAL

US tests Mideast peace waters

By Judy Dempsey in Jerusalem

Dennis Ross, US Middle East envoy, arrives in the region today to assess whether the time is right for the US to put forward proposals to kick-start Israeli-Palestinian peace talks.

The US is under pressure from Israel not to present a plan envisaging a second phased Israeli troop withdrawal from the West Bank with just over 13 per cent of land being handed to the Palestinians. Only 3 per cent of the West Bank and 26 per cent of the Palestinian population is under full Palestinian control.

The Israeli cabinet has already rejected the US plan although the European Union wants Washington to go ahead with it. Kofi Annan, United Nations sec-

retary general, yesterday told Israeli parliamentarians to honour land for peace, saying Israel was responsible for "provocative acts" including building Jewish settlements and confiscating land.

But in a bid to buy time and pre-empt pressure from the US, EU and the UN, Benjamin Netanyahu, Israeli prime minister, said he would unveil his own proposals in the coming days.

The plan, according to officials, entails handing back in a second, staggered withdrawal about 9 per cent of the West Bank to the Palestinians, provided they "fully comply" with the Oslo peace accords, including action to combat terrorism.

They said the third troop pullback would be implemented only during the final

status talks. This, diplomats say, would further strengthen Israel's negotiating position and contravene the Oslo peace accords under which the third pullback should take place by the middle of this year.

The plan will be unveiled during the Knesset (parliament) recess to preempt any no-confidence votes by nationalists in the coalition who oppose any pullback. But there is concern Mr Netanyahu could assuage nationalists and settlers by releasing land for building homes at Har Homa, the controversial new settlement in east Jerusalem. Diplomats said the consequences of such a move would be "catastrophic".

The Palestinian Authority fear Mr Netanyahu's proposals will reduce US and EU

pressure with the result that Israel will be "the judge and the jury" in establishing the criteria for compliance. "We need outsiders to prove to Israel we are fighting against terrorism," said a Palestinian official.

To measure such compliance - and revive the peace talks - the Central Intelligence Agency and Israeli and Palestinian security services recently suggested putting security co-operation among them on a formal footing. Mr Netanyahu rejected this because it involved a third party monitoring the Palestinian Authority's measures against terrorism.

The EU also offered to monitor compliance but Israel ruled out any direct EU involvement in Israeli-Palestinian talks.



UN secretary general Kofi Annan and his wife Nana at the Wallenberg memorial in Jerusalem yesterday. Mrs Annan is a niece of the Swedish diplomat who saved hundreds of Jews from Nazi death camps. Picture AP

Clinton accepts share of blame for genocide

By Michela Wrong in Kampala

President Bill Clinton yesterday met maimed survivors of Rwanda's 1994 genocide and acknowledged the world had not done enough to stop the state-sponsored massacres.

Visibly shaken, he listened to chilling personal stories. One woman had lost nine members of her family in a 90-day killing spree. Another saw her parents and four siblings die.

Orchestrated by the Hutu-dominated government and *interahamwe* militias, the slaughter took place, Mr Clinton acknowledged, while "all over the world there were people like me sitting in their offices... who did not fully appreciate the depth and the speed with which you were being engulfed".

"The international community, together with nations in Africa, must bear its share of responsibility for this tragedy," he told an audience assembled for his three-hour stopover from neighbouring Uganda.

"We did not act quickly enough after the killing began. We should not have allowed the refugee camps to become safe havens for the killers. We did not immediately call these crimes by their rightful name: genocide."

The heart-felt mea culpa included pledges aimed at preventing a repetition of the butchery. International mechanisms for identifying nations in danger of genocidal violence must be improved, Mr Clinton said. He also promised to support a much-criticised international tribunal trying Rwanda's suspected killers as long as necessary and to back the establishment of a permanent UN international criminal court.

But the fact that his visit did not take him outside the airport precincts, not even as far as a genocide memorial constructed 150 metres from the terminal, underlined the bitter realities of Rwanda

four years after the killings. Attacks by Hutu extremists who fled the Rwanda Patriotic Front advance have gone from border raids to low-level civil war and the Tutsi-dominated Rwandan government's assurances that it had security under control was undermined only this week by the hostage-taking of a group of Catholic nuns.

Critics of US policy in the Great Lakes said last night that Mr Clinton's speech had failed to take account of ruthless tactics employed by each side, charging him with failing to address the suspected 1997 massacres of Hutu refugees who fled into Democratic Congo.

Human rights experts believe these killings were largely carried out by Rwandese soldiers operating across the border and determined to eliminate a perceived future threat.

That issue was instead likely to have been raised with Laurent Kabila, the rebel leader who toppled Zaire's Mobutu Sese Seko, when he met Mr Clinton at a regional summit in Entebbe yesterday.

The summit brought together most of the men regarded as a "new breed" of progressive leaders that Washington wants to engage: Uganda's Yoweri Museveni, Rwanda's Pasteur Bizimungu, Ethiopia's Meles Zenawi and Tanzania's Benjamin Mkapa. But it also included President Daniel arap Moi of Kenya, increasingly sidelined by the US administration.

The leaders signed a commitment with President Clinton to deepen respect for human rights as the shared "birthright of all men and women everywhere". The United States "can help this continent reach its full potential in the 21st century," Clinton said after the three-hour summit. "We can be a force for good together and all our nations can be proud."

Lex Column, Page 12

Putting down routes: ebb and flow in Caspian pipeline politics

A link with Turkey now looks imminent, but the diplomatic and commercial contest is far from over, writes Bruce Clark

late last year, one of the architects of Washington's strategy in the Caspian emerged from retirement to issue a blunt message: the US might be losing the battle to guide the region's energy flows towards western markets.

US officials insist that the picture has improved, from their viewpoint, since the warning delivered in a newspaper article by Sheila Healin, a former National Security Council strategist. Several encouraging developments have boosted their hopes that Turkey, rather than Russia or Iran, will provide the most important export route for energy from the former Soviet republics.

But the diplomatic and commercial contest is far from over - in spite of a series of upbeat predictions that a final decision is only months away on the construction of a giant pipeline linking Baku in Azerbaijan with Ceyhan in southern Turkey.

The governments of the US, Turkey and Azerbaijan have all declared their

strong support for this pipeline, which would cost at least \$2.5bn and run through several potential zones of conflict on its 1,700km route. But consensus still has to be reached among the partners in Azerbaijan's main oil consortium, which include US, UK, Russian, Turkish and Japanese concerns.

Ms Healin's gloomy prognosis highlighted two unwelcome pieces of news for US policy-makers: the strong interest shown by European companies such as Royal Dutch-Shell in building pipelines across Iran, and a Franco-Russian contract to extract gas off the southern Iranian coast. These developments, she noted, highlighted the difficulties faced by Washington as it seeks to minimise the involvement of Iran in the region's long-term energy developments.

But US officials insist that the outlook for their vision of the Caspian region's future - one of multiple pipeline routes designed to avoid giving any country a stranglehold - has bright-



ened in a number of ways.

First, Russia has moderated its position on the sharing out of the Caspian's riches by joining Kazakhstan in calling for an early agreement on dividing up the seabed's resources.

Second, there are hopes of a settlement in a Caspian demarcation dispute between the gas-rich state of Turkmenistan and Azerbaijan, a republic on which western policy has taken a giant bet. A third, intriguing factor to enter the equation is the prospect of "gas leading oil" - with a gas pipeline shadowing the proposed oil pipeline from central Asia to

the Mediterranean and providing an extra justification for the use of that route.

Unocal, a US energy concern with an appetite for bold pipeline proposals, announced last month that it was teaming up with Turkey's Koc group to study the feasibility of a gas route running westwards across the Caspian and then into central Turkey and beyond.

US policy-makers are sympathetic to the idea of pipelines under the Caspian - with the potential to free Turkmenistan and points east from dependence on Iran and Russia. They would prefer to see Turkey's fast-

growing demand for gas being met by a trans-Caspian pipeline, rather than directly from Russia.

The commercial logic for a Baku-Ceyhan oil pipeline may be challenged by sceptics, at a time when world crude prices are falling, and alternative routes through Russia and Georgia can probably cope with 400,000 of the 700,000 barrels a day which the main Azerbaijan consortium expects to produce. But supporters of the gas pipeline idea can point to estimates that gas consumption in Turkey is likely to quadruple in 12 years.

While the trans-Caspian line presents huge technical challenges, Russia has made an even bolder counter-proposal: the construction of an under-sea gas route linking its port of Tuzovsk with Samson on the north Turkish coast.

The reaction to this proposal in Washington has been cool. "We don't find this helpful," said a US official. "We would enhance Russia's already preponderant position in the Turkish gas market."

The alternative of building an energy route from Azerbaijan to Turkey need not exclude Russian participa-

tion, the official added.

But as experts on the region point out, there are still several wild cards in the game. A mildly sceptical audience assembled for his three-hour stopover from neighbouring Uganda. "We did not act quickly enough after the killing began. We should not have allowed the refugee camps to become safe havens for the killers. We did not immediately call these crimes by their rightful name: genocide."

The same message - that Iran is almost impossible to exclude from the energy game - will be given in Washington next month by Turkmenistan's President Saparmurat Niyazov.

Another joker in the pack is the conflict between Azerbaijan and Armenia. If the conflict over the Nagorno-Karabakh region is settled, it could provide an ideal route for a Caspian-Mediterranean pipeline. If the conflict flares up, even the route now currently mooted for the pipeline could become problematic.

Rail link scheme may face new threat

By Jonathan Ford and Charles
Batschelet in London

Railtrack, operator of the UK rail infrastructure, would buy the first section of the Channel tunnel rail link through the southern England county of Kent when it has been completed but would only take an option to acquire the second more expensive stage into central London, according to the latest proposals to rescue the £5.4bn (\$9bn) project. The tunnel runs between England and France.

Railtrack's reluctance to underwrite the whole construction pro-

cess would not prevent the deal from going ahead, observers close to the transaction claim. But any deal that left open the possibility that the second stage would not be completed could not be sold to ministers.

Details of Railtrack's plans emerged on the day that it unveiled a £16.5bn, 10-year spending programme to maintain and upgrade the UK rail network. John Swift, the rail regulator, declared that he was still not satisfied and demanded firmer spending commitments.

John Prescott, deputy prime min-

ister, is due to announce the outcome of negotiations about the rail link within the next few days. If Railtrack and the shareholders in London & Continental Railways have put together a convincing proposal, he is expected to give them more time to complete the details.

LCR's first attempt to finance the project fell apart in January when it was forced to ask the government for a further £1.2bn of public subsidy on top of the £1.8bn already agreed.

But revelations about the LCR-Railtrack proposals prompted

claims from some of the rejected earlier bidders for the rail project that by failing to seek competing offers, the government had missed an opportunity to strike a better deal for the taxpayer.

Eurorail, a consortium headed by Kraemer, the construction and shipping group, that came second in the bidding for the link in 1996 and Hochtief, a German construction group, are both known to be interested in bidding again to take on the project.

Eurorail is understood to have received legal advice that the government could offer it the contract

without going through a time-consuming and costly re-tendering process.

Eurorail has offered to revive its bid for the project but apart from one informal meeting the government has refused further meetings with the consortium.

Under the latest Railtrack proposals, the company would agree to buy the first section of the link at a price that would reflect the cost of construction. LCR would then use this contract as a guarantee, allowing it to raise sufficient cash through bond issues to finance construction.

Authority plans to quadruple fines on firms

By George Graham,
Banking Editor

The Securities and Futures Authority, which regulates brokers and investment banks, plans to increase its fines to bring it into line with other regulators.

But the SFA also intends to give more credit to member firms which own up to problems and deal with them properly, in the hope of persuading more companies to report problems.

Nick Durlacher, SFA chairman, said: "We have made an effort at better defining the stick and carrot approach."

Although the SFA is expected to be rolled into the Financial Services Authority, the new single regulator, by the turn of the century, the new scale of penalties could still be operating for years to come as disciplinary cases can often take four or five years to complete.

The biggest fine the SFA has levied against a member firm was £500,000 (\$835,000.00), brought last year against Swiss Bank Corporation for two separate offences.

The Investment Management Regulatory Organisation has levied fines of up to £2m, and the Personal Investment Authority has also increased its tariff.

"It seemed to us our fines had got stuck in a rut," Mr Durlacher said.

The SFA will recommend to disciplinary tribunals that they should multiply the penalties by four for firms and by two for individuals since they are less likely to be able to pay large fines.

But the regulator also wants to encourage firms to report problems by assuring them they will not necessarily bring disciplinary action upon themselves.

The SFA is particularly keen to increase the number of reports of "dirty withdrawals", where a trader or investment banker leaves a company because he has done something wrong, such as mis-valuing his positions.

Unless the case is reported, the trader may be able to do the same thing at another company.

Mr Durlacher said many firms appeared to be taking the easy option of letting an individual leave quietly.

"We have a deep suspicion that the number of dirty withdrawals we get does not reflect the reality. It just gets swept under the carpet, and we'd much rather have it brought to light."

George Storer, a partner at solicitors Clifford Chance and a former director of the Serious Fraud Office, welcomed the SFA's move to give credit to companies which reported problems, but questioned the proposal to multiply the scale of fines by four.

Mayoral candidate gives Blair shivers

Ken Livingstone, London's most colourful civic leader since Dick Whittington, yesterday confirmed Tony Blair's worst fears by announcing his ambition to become the capital's first elected mayor.

"Red Ken", now a left-wing Labour MP, was the most demonised man in British politics during his reign at the Greater London Council from 1981 until it was abolished in 1986. There is every chance he could become as much of an irritant to the prime minister as he was to his arch-enemy, Margaret Thatcher, the former Conservative premier, now Baroness Thatcher.

Dressed in his trademark baggy safari suit, Mr Livingstone told a press conference that he was worried that the government's plans for London would leave too much power in the hands of the mayor. That was why he wanted the job.

"If you have an all-powerful mayor, you open up the prospect of someone going raving mad and abusing those powers," he said.

"It is far better to have someone like myself, who will exercise restraint, than someone else - like a well-known author," he grinned.

The world is accustomed to idiosyncratic and extrovert mayors, but London's first mayoral elections could be a real test. The prospect of the new-loving Mr Livingstone slugging it out with Lord (Jeffrey) Archer, the Conservative novelist, is a real possibility.

Mr Livingstone's announcement eclipsed publication of detailed proposals for a directly elected mayor and assembly. Subject to a London referendum on May 7, the first elections will take place in autumn 1999 or spring 2000. Picture Jason Orton



UTILITIES GOVERNMENT PROPOSALS

Move to force share-out of excess profits

By Andrew Taylor
and David Wighton

A package of measures designed to prevent electricity, gas, telecommunications and water companies from making excessive profits was proposed yesterday by the government.

A discussion document called on utility regulators to develop mechanisms enabling consumers and shareholders to share excessive gains when companies had "deliberately misled the regulator by providing incomplete or inaccurate information".

It also suggested companies might have to share big profit increases when they had benefited from factors outside their control, such as fuel prices falling sharply, said Margaret Beckett, chief industry minister.

But, after pressure from the government and the Treasury, the consultation document makes clear that the status quo is an option. "One approach would be to rely exclusively on RPI-X," it says.

Potential sellers include Atlanta-based Southern group, which is reported to be willing to dispose of all or part of South West Electricity for which it paid £1.1bn (\$1.8bn) in 1995. Others thought to be considering selling supply operations include American Electric Power, which last year paid £1.5bn for Yorkshire Electricity.

The industry regulators welcomed the decision to retain RPI-X and pointed out that there were already mechanisms in place to claw back excess profits. Even if

the government introduced new "error correction mechanisms" it was unlikely to lead to substantial changes, they said.

Clare Spottiswoode, director-general of Ofgas, the gas industry regulator, said: "I welcome the fact that government has recognised that economic regulation should continue to be run by independent regulators."

The document also contains the expected proposal to separate the supply and distribution elements of electricity licences.

The move, which is expected to trigger a restructuring of the industry, comes as suppliers have been struggling to install the complex and expensive computer software systems needed for when the domestic electricity market, covering 25m customers, opens to competition this September.

Several US owners of UK electricity companies, angered by last year's windfall tax and disenchanted by the low margins on supply, are understood to be considering selling this side of their operations.

UK and European police chiefs fear the French decision to set up TV screens around the country showing live coverage of matches will attract thousands without tickets and make it harder to control fans' movements.

PERSONAL VIEW Gregory Palast

Regulators could learn from Texas chicken chef

From the US, the need for reform of Britain's system of utility regulation seems obvious. Britons pay nearly double the US price for electricity, double for local telephone calls and triple the US price for a litre of water.

I suggest the government takes some lessons in effective utility regulation from Kenneth Williams, owner of Leonard's Barbecue Chicken Shack in Houston, Texas. Two years ago, Mr Williams forced the giant electricity monopoly, Houston Industries, to reduce its prices by \$1.5bn.

Mr Williams had become suspicious of the electricity company's big rise in reported profits and asserted his right as a citizen to open a public inquiry. To back his demands, he invoked a US right to complete access to the account books and records of the privately owned utility.

Every US consumer has the right to look at accounts books, inventory lists, even hand-scrawled memos locked in the desk of the electricity company president. Faced with having its financial soul laid open to public scrutiny, Houston agreed to cut its prices.

How is it that a Texas

chicken chef has had more success in controlling utility prices than Britain's expert regulators? To find out, let us do an autopsy on a recent and obvious blunder by a UK regulator which will cost the public a bundle in higher electricity bills.

In November, National Grid floated a portion of Energis, its subsidiary which strings fibre optic cables on National Grid power pylons. Shares sold out instantly based on a value for Energis of \$294m (\$1.5bn).

But the windfall will come out of the pockets of electricity customers in England and Wales. Every customer must pay for the National Grid to transmit power. The government sets prices based on National Grid's total value - less the value of the Energis subsidiary. Therefore, the Energis flotation should have cut power charges by \$294m.

But it did not. In calculating National Grid prices, the regulator, Stephen Littlechild, valued Energis at \$250m. His mistake will cost Britain's consumers \$44m. I asked the professor how he could have missed half a billion pounds.

"Because they [Grid executives] told me that Energis was risky, its value might be negative," he said.

Prof Littlechild was at a distinct disadvantage in facing down the utility chiefs. He had no access to the management's own projections and bankers' opinions which, undoubtedly, valued Energis closer to reality. In the US, such crucial documents would have been available for review by any curious chicken cook.

Also, consider where the ill deed was done: behind locked doors, with the government regulator closeted privately with the utility honchos.

To British eyes, the US system is a shock. One Labour frontbencher shuddered at the concept of the US system. "It's too litigious, too complex, too many lawyers."

And it is true. US free-for-all public hearings are loud, messy, contentious and highly politicised - in a word, democratic.

Gregory Palast in New York won the 1997 David Thomas Prize, awarded in memory of the Financial Times reporter killed in 1991 on assignment in the Middle East.

NEWS DIGEST

NORTHERN IRELAND

Senator Mitchell insists on agreement deadline

George Mitchell, the former US senator chairing the Northern Ireland peace talks, yesterday took the stalled negotiations by the scruff of the neck, announcing for the first time an explicit target date of April 9 to bring the process to "a swift and favourable conclusion".

After three days of frustrating deliberations at Stormont Castle, Belfast, the region's principal city, Senator Mitchell said: "The time for discussion is over. It is now time for decision."

Setting out a detailed schedule for the first two weeks of non-stop negotiations, Mr Mitchell said the participants would meet for all five days next week and the following week.

"The participants will remain in session continuously until these negotiations are concluded. We hope and expect that can be accomplished by Thursday April 9."

The British and Irish governments had already set the Easter week beginning April 6 as a deadline for the deal. The plan was to put a settlement to the people in referendums on both sides of the border in late May well ahead of the confrontational "marching season" in July.

Senator Mitchell's decision to spell out an explicit deadline will put additional pressure on the parties to reach an historic settlement of the Irish question.

The initiative was welcomed by the nationalist Social Democratic and Labour party. "We could be at this for ever if we don't set a deadline," said one SDLP official.

However, much will depend on the response of the Ulster Unionists to the senator's personal intervention, amid suggestions this week the UUP was seeking to frustrate the timetable by questioning the eligibility of Sinn Féin, political wing of the Irish Republican Army, to remain at the table. After a spate of terrorist attacks in recent weeks by splinter groups opposed to the process, Mr Mitchell urged the parties to show courageous leadership and maintain steady nerves. John Murray Brown, Dublin

PENSIONS

'Compulsion' plea by insurers

Three leading insurance groups are urging the government to make pensions compulsory for millions of workers who are not currently saving enough for their retirement.

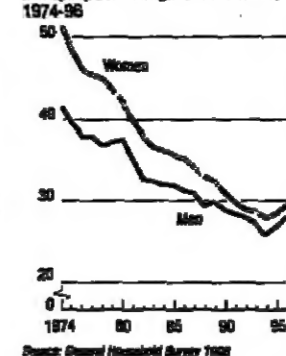
In a joint submission to John Denham, pensions minister, Prudential, Standard Life and Norwich Union say such compulsion is the only way the state will achieve "adequate pensions for all" given its own reluctance to meet the bill. They do not recommend compulsion for everyone, saying some people simply cannot afford it. The three groups share between 15 and 20 per cent of the personal pensions market.

They say pensions saving should be made compulsory for about 8m workers - mainly those who are not in employers' schemes, are self-employed, or who are not contributing adequately to a personal pension of their own. The government is due to publish a discussion document on welfare reform, including pensions, today. Christopher Brown-Humes, London

SOCIAL SNAPSHOT

More women take up smoking

Cigarette smoking
% of people smoking in Great Britain,
1974-95



The proportion of women in Britain who smoke has started to rise in the past couple of years after more than 20 years of steady decline, the latest General Household Survey reveals. The 26th annual snapshot of British life, published today, shows the proportion of women smoking rose between 1994 and 1996 from 26 to 28 per cent, just short of the 29 per cent of men who smoke. Men and women aged 20-24 are more likely than any other age group to smoke - 42 and 38 per cent respectively. And young men aged 16-19 are the most likely to smoke high-tar cigarettes. In comparison, people aged over 60 are the least likely to smoke cigarettes - 18 per cent of men and 18 per cent of women. Simon Buckley, London

FILM INDUSTRY

Minister unveils funding plans

Chris Smith, chief culture minister, yesterday unveiled proposals to raise up to £25m (\$42m) a year from the film industry and the National Lottery to invest in film training, distribution and cinema promotion.

The proposals were included in a package of recommendations published yesterday by the Film Policy Review Group, a body of film executives created by Mr Smith to modernise UK film policy. Other proposals included setting up a Los Angeles office to promote the UK as a production centre and launching an annual international film market in London. Alice Rawsthorn, London

Soccer violence threat prompts TV campaign

By Jimmy Burns in London

The British government yesterday launched a TV advertising campaign as part of its strategy to prevent English and Scottish hooligans disrupting this summer's World Cup soccer competition in France.

An advertisement will be regularly shown on commercial and satellite TV between now and early May, showing a fan celebrating acquiring a ticket. He is then refused entry into a stadium because his name does not match that on the ticket.

Jack Straw, the home secretary, said: "The campaign is targeted at those who think that being in posses-

sion of a ticket bought on the black market guarantees you a seat - it does not. The best advice we can give to supporters is 'No ticket, don't travel'."

With just over three months to go before the start of the World Cup, demand for tickets is far outstripping their availability. The government, which hopes the UK can stage the competition in 2006, fears thousands of fans may be planning to hop across the English Channel to France hoping to get a black market ticket, making policing more difficult.

The government's campaign assumes stadium officials and police will be will-

ing and able to check the identity of thousands of ticket holders before matches. French police have already said they will not. And tickets sold to fans in France will be the only ones with holders' names on.

David Dryer, a leading UK sports tour operator, said yesterday: "The idea that you can control the black market or persuade people to stop travelling to France is absolute nonsense."

UK and European police chiefs fear the French decision to set up TV screens around the country showing live coverage of matches will attract thousands without tickets and make it harder to control fans' movements.

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CONTRACTS & TENDERS

TOPLITNA OSKRBA d.o.o. Maribor, SLOVENIA ('TOM') hereby announces to international investors its INVITATION TO BID to become TOM's partner in the development of the MARIBOR IPP PROJECT

TOM, the district heating company of the city of Maribor, Slovenia, is seeking an international strategic investor partner to complete development of the Maribor IPP Project (the 'Project'). TOM is presently developing a gas-fired, combined cycle, cogeneration facility to be constructed on TOM's existing site in Maribor. The proposed facility would have electric capacity of 58 MW and thermal capacity of 39 MW, bringing the total thermal capacity to 142 MW. Technical and economic analyses of the concept have been completed, and letters of intent from the power and heat purchasers and the gas supplier have been provided.

The Project is described in detail in an Information Memorandum prepared by TOM's consultant Lahmeyer International (Germany). Potential investor partners may purchase the Request for Proposal ('RFP') and the Information Memorandum ('IM'), visit the data room inside TOM, and conduct on-site due diligence. Investors may bid alone or in consortium.

Parties wishing to submit a proposal should contact TOM d.o.o., Jadranska c.28, 2000 Maribor, SLOVENIA (Tel. +386-62-301-181/Fax. +386-62-301-711). TOM will provide potential investors with a Confidentiality Agreement. After returning the signed Agreement along with an irrevocable bank cheque in the amount of ECU 1000 (one thousand) to TOM, the investor will receive the tender documents (RFP and IM) by courier.

A pre-bid conference will be held on 04 May 1998 at 10.00 in TOM's offices in Maribor. The final date of submission of proposals is 05 June 1998 at 10.00. The first ranked investor partner will be invited for negotiations at the beginning of July 1998.

MANAGEMENT & TECHNOLOGY

MANAGEMENT PRODUCT DEVELOPMENT

Whirlpool's platform for growth

Peter Marsh and Nikki Tait look at plans to rationalise the global production of domestic appliances

If you've heard of the "world car" - now there is the "world cooker". More than 2,000 engineers are being mobilised by Whirlpool of the US, one of the world's two biggest makers of white goods, to bring product development in home appliances into line with automotive industry practice.

The company believes that by globalising the development of new products from air conditioners to dishwashers, it can introduce more innovative designs more quickly and at lower cost, pleasing both consumers and shareholders.

The plan, put into operation in the past few months, will base development of new products on "platforms". These will contain the technological heart of the appliance and will be the same all over the world. The parts the consumer sees - and which ensure that a cooker or refrigerator satisfies consumer tastes in specific regions - will be built on to the platform relatively late in the production process.

The project is based partly on experience in the car industry where the platform principle has evolved during the 1990s at companies such as General Motors, Volkswagen and Fiat.

Similar concepts are being tried in industries including tractors, lift trucks and printing equipment, but rarely on the scale that Whirlpool is attempting. The company believes its platform strategy puts it two to three years ahead of competitors in the

world's \$85bn-a-year white goods industry.

To David Whitwam, Whirlpool's chairman, the scheme is a logical development of efforts to turn Whirlpool into a truly global company. Last year Whirlpool had sales of \$8.5bn, one-third outside the US. In spite of setbacks linked to the faltering economies of South America and south-east Asia, the company is determined to build sales in emerging markets as well as in Europe, where it is the third biggest supplier of domestic appliances behind Electrolux of Sweden and Bosch-Siemens of Germany. Companies like Whirlpool have to recognise, Mr Whitwam says, that consumers in separate markets differ. "Their products end up looking different - bigger freezers in one market, smaller freezers in another, big kitchens in some markets, and so on. But if you back away from that, the basic technology, the product technology, is exactly the same."

It therefore makes sense to divide products in two. Behind what Whirlpool calls the "green line" is the platform. For a refrigerator, this includes the casing, compressor, evaporator and sealant system. In front of the green line are the features that define the product: the door, the layout of the shelves, the position of any freezing cabinet, the air-blowing system to get rid of frosting, and the controls.

Whirlpool divides its business into six areas: microwave ovens, air condi-

tioners, dishwashers, laundry products, refrigerators and conventional cookers. The 2,000 product engineers working on the appliances - made in 35 factories around the world - are split into teams to look at common parts and subsystems.

According to Ron Kerber, who as Whirlpool's chief technology officer is in charge of the project, the 135 platforms that support the company's different models worldwide will, within five years, be brought down to 65. "We should be able to make a richer mix of products by migrating ideas between different development groups," he says.

Through the process, Whirlpool is looking to reduce its \$200m-a-year development bill by 10 per cent, increasing the productivity of its product design team by 30 per cent. By putting component sourcing on a worldwide basis and cutting its suppliers, Whirlpool should also be able to reduce purchasing costs by \$180m.

The changes are already bringing upheavals for Whirlpool's design staff, who previously worked fairly autonomously on products for different parts of the world. In the case of dishwashers, the products for the main markets in North America and Europe are quite different. Because in many US homes the machines double as garbage disposers, US-style dishwashers have mechanisms for chopping up bits of food. They also use more energy and water, and tend to be noisier.

But the 180 product engineers from Whirlpool that are joining together have realised that the differences

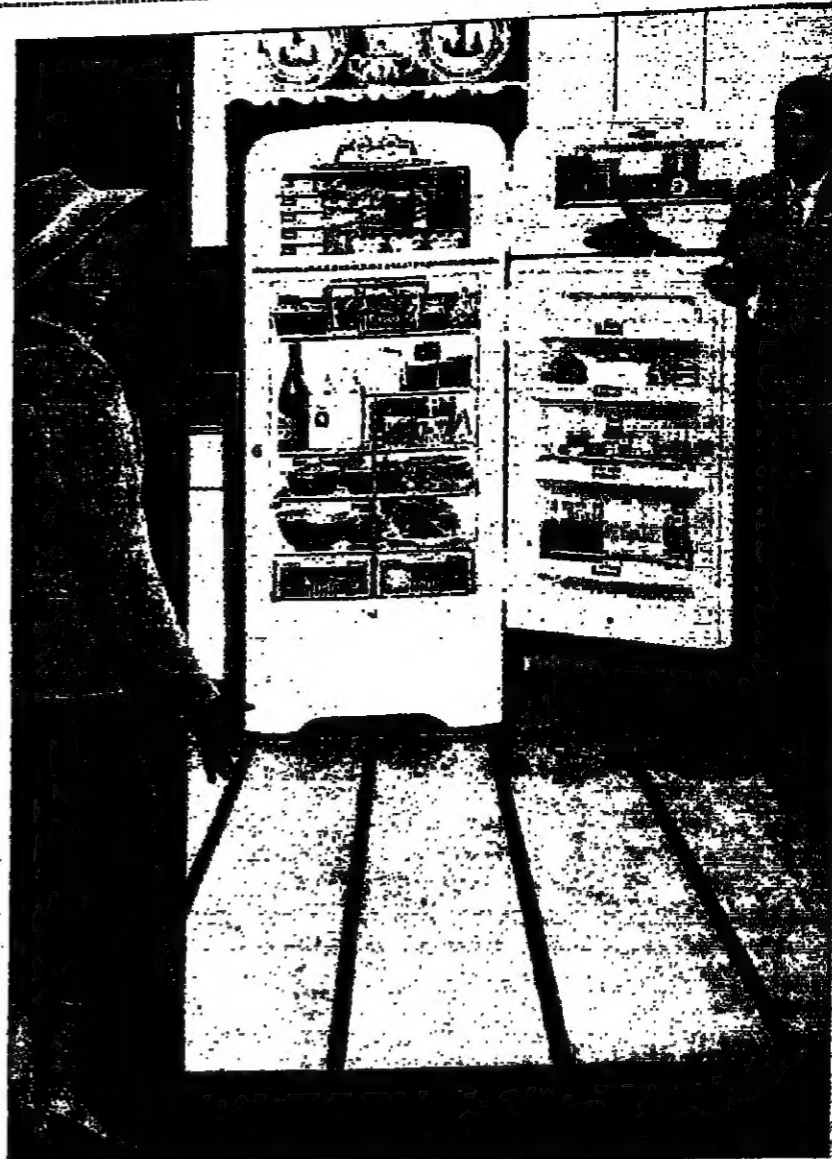
between them are fewer than they thought. As a result, the six basic platforms used to support different dishwasher models will be cut to three by 2002.

Fridges are notoriously hard to make on a world basis, because consumer tastes vary so enormously: US consumers prefer "larder-size" cabinets, which nearly all contain air-blowing systems to make them frost-free; the Germans want lots of space for meat, while the Italians are keen on special vegetable compartments. To cater for the large number of vegetarians in India, often within families that contain meat eaters, the fridges often require internal sealing systems to stop smells of different foods intermingling.

This diversity is behind the large number of existing platforms for fridges - 48, which the company wants to reduce to 25 by early next decade.

Aiding the process is a Whirlpool internet website for fridge features, setting out about 170 ways of specifying or arranging parts such as lettuce crispers or shelving units, which engineers can look up to smooth the product design process.

"In this way an engineer in Brazil who wants a specific aspect for a new refrigerator can look up the website and borrow an idea that has already been invented for a product in the US or Europe," says Jerry Weinstein, the company's head of refrigerator development. Such techniques are part of Mr Whitwam's effort to establish a "global mindset", which he believes is essential to the company's future.



Cold logic: fewer models could revolutionise production. Advertising Archives

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TECHNOLOGY WORTH WATCHING

Wider viewing angle
for LCD could lead to
compact screens

A potential breakthrough in liquid crystal display technology could pave the way for lighter, more compact television screens.

Researchers at the Defence Evaluation and Research Agency in Malvern in the UK have managed to enlarge the viewing angle of the LCD screen without reducing its brightness, according to today's Nature, the international science journal.

As a result, they hope to increase the optical performance of LCDs to the point at which they could be used in desktop monitors and televisions. The technique does not require any additional electronic circuitry and so could be produced for little more than a conventional display.

Most LCDs use a "twisted nematic" configuration of liquid crystals. Applying an electric field turns the display black or clear by altering the tilt angle of the molecules. The snag with this approach is that the brightness depends strongly on the viewing angle.

The DERA scientists have found a way of inducing a voltage-dependent twist of the molecules. Relying on changes in the twist, rather than the tilt of the molecules, means the display does not suffer from restrictions in viewing angle. Defence Evaluation and Research Agency: UK, tel 01784 896590; fax 01784 896530.

Satellites
aid study
of earthquakes

Studying earthquakes has always been difficult because the plates of the earth's crust move so slowly. Now radio signals from global positioning satellites are making it possible to take accurate, up-to-date measurements of the plates' movements.

The geologists are able to measure the positions of markers thousands of miles apart to a precision of less than an inch. According to researchers at Northwestern University, Illinois, the GPS data allows geologists to study the slow squeezing within the interior of plates. It also makes it possible to study what is happening in zones along plate boundaries, where most earthquakes, volcanoes and geological action occur. Northwestern University: US, tel 647 4813115; e-mail b-burton@nwu.edu

The robot that
clears away
asbestos

A crawling robot that can remove asbestos from the outside of pipes could be a faster and safer alternative to humans when it comes to cleaning up older buildings.

Researchers at Carnegie Mellon University in Pittsburgh believe that the robot, known as BOA, offers the first safe, economical, mechanical solution to the problem of removing asbestos insulation.

The machine can operate at a rate of 30ft per hour, which is about 10 times faster than a human operator.

The robot, which is operated by remote control, crawls along the outside of the pipes and "chews" off the insulating materials. The tiny, carcinogenic particles are captured using a fast-drying adhesive. The waste material is then sucked away by a vacuum hose.

The device was conceived as part of a robotics technology programme initiated by the Department of Energy to help decontaminate and clean up its nuclear weapons sites and other polluted areas.

One of the main challenges was to build a sophisticated robot capable of handling hazardous material that was small enough to operate in a confined space. Carnegie Mellon University: US, tel 412 2683630; http://www.cmu.edu/

Infrared light
detects brain
damage in babies

A technique to detect potential brain damage in premature or oxygen-starved babies has been developed at University College London, writes Tatum Anderson.

The device overcomes the problems associated with assessing brain damage in new-born babies because they cannot stay awake and remain still for long periods of time while a brain scan is taken.

The device is placed on the baby's head and emits infrared light which passes through the baby's skull. It then detects how much of the light is absorbed by haemoglobin, the pigment in the blood which carries oxygen.

The baby is stimulated by visual images as the test takes place. It processes them using part of its brain at the back of its head, which can be monitored by the detector. The aim of the project, sponsored by the Action Research charity, is to build up a picture of a normal baby's visual development in order to assess differences that occur in premature babies. Action Research: UK, tel 01403 210408; fax 01403 210541.

Small-scale water
distribution systems
made cleaner

A company on Merseyside in north-west England has developed a water disinfectant system using chlorine dioxide that is effective against amoebae and legionella and applicable in small-scale water distribution systems, writes Sheila Jones.

Activ-Ox, developed by Feedwater, releases high levels of chlorine dioxide by adding a weakly acidic liquid, allowing oxygen, rather than chlorine, to disinfect.

Chlorine dioxide is used mainly in specialist applications where chlorine is inappropriate, such as the treatment of municipal water supplies and in the drinks industry. Feedwater says its system can be used in smaller applications because of its use of weak acid and more controllable dosing system.

Unlike chlorination, the process does not react with chemical compounds which can release harmful byproducts. Feedwater: UK, tel 0151 606 0808; fax 0151 678 5459.

Vanessa Houlder

CINEMA

Punchy pugilism needs firm hands

Natural talent should be saved by the bell, argues Nigel Andrews

Some film-makers are described as "natural talents". But how much should nature and talent be trusted together? In British writer-director Shane Meadows's lively, uneven, sometimes downright maddening comedy-drama *TwentyFourSeven*, we keep wishing nature would get out of the way to let nurture in; that nurture would say firm things like "Get the tone right" or "Cut the choral music" or "For goodness' sake drop the DIY martyrdom motif."

This Midlands-set tale of a boys' boxing club, founded and run by do-gooder and ex-pugilist Bob Hoskins, is shot with perky immediacy in black and white. Meadows - more power to him - is no respecter of textbook film grammar. There is no orderly succession of master shot, medium shot, close shot. He just handwrites with the camera like the French New Wave of old, who ran about the streets and coined the phrase "camera-stylo".

He also has an off-the-wall, sometime off-the-map, sense of humour. The boxers rounded up by Hoskins, who aims to spread peace by training and gloving the neighbourhood's chief delinquents, are an often hilarious group of no-hopers and/or no-brainers. Drug addict Fagash spends his evenings Swami-posed at home, reviewing his narcotic options. "Tet Tonka" is a boy with an eating disorder whose father wants to panic him into weight-loss. And

other members of the half-maimed and mentally disadvantaged queue up to be cured by Hoskins's organised knockabouts.

At times *TwentyFourSeven*, which has been hugely praised at festivals, is like a comedy directed by a British Scorsese: fierce, punchy and with a useful demotic humour. Meadows has a genius for the throw-away scene. Hoskins practicing his chat-up speech for a shopgirl he fancies; a street

TWENTYFOURSEVEN
Shane Meadows

MOTHER AND SON
Aleksandr Sokurov

ANASTASIA
Don Bluth and Gary Goldman

BEST MEN
Tamsin Davis

LES VOLEURS
André Téchiné

quarrel on the subject of "spitting on your chips"; or more unnerving flashpoints when violence flares from nowhere, with a face slammed against a car's side or a domestic yelling match whose emotional toll is caught in the tiny, slow-motion postscript of a wife's drooping head.

Late on, though, the film goes almost completely to pieces. Meadows decides to up the ante, or the arty, and give Hoskins a tragic summation. A man is killed in a drawn-out fist fight, stylised and archly slo-mo-

tion'd to the sound of choir music, and Hoskins, dishonoured for defending his kids, vanishes into a scruffy martyrdom, to be shaken out for final honours in the framing sequence.

At these moments *TwentyFourSeven* has the glutinous piety of a bad Children's Film Foundation feature. Hoskins himself ends up like some unthinking man's Robin Williams: a sainted bearded who can save us all, a "bad will hunter" who roots out wickedness and takes it Christ-like upon himself. That is the trouble with a natural talent like Meadows's. It can "naturally" turn to mush and message-mongering. What he needs is the benevolent intervention of a mentor. Is there a firm-minded producer in the house?

Aleksandr Sokurov's *Mother And Son* is at once powerful and inexplicable. Nothing happens for 74 minutes, yet at times we are gripped as by a great painting. That is what the film almost is. Limiting the slender tale of a man's last hours spent caring for a dying mother - cradling her in bed, comforting her with memories, carrying her on a last "walk" into the countryside - the Russian director draws out time, space and perception so that we feel every breath, every scintilla of each.

But is it great cinema, as some have claimed, including filmmakers Tarkovsky and Paul Schrader? Or is it the flimic equivalent of a religious trance state: fascinating but also alienatingly private and "painted" in an old-masterly style which Sokurov says he based on Caspar David Friedrich but



Bob Hoskins in Shane Meadows's *TwentyFourSeven*; he ends up like some unthinking man's Robin Williams

which also evokes the sickly, retro pietism of the Pre-Raphaelites. I grew increasingly sceptical while others grew increasingly impressed. See and make up your own mind, while the debate lasts. Thanks to science, the "what if?" behind *Anastasia* has grown larger since this animated feature, the first from 20th Century Fox, went into production. It is no longer "What if the surviving Russian princess had fled St Petersburg to a new life in Paris?", rather "What if we ignore the now conclusive evidence that she didn't survive at all but was shot with the other Romanovs?"

But why let history interfere with Hollywood? It seldom has before. Better the myth, which in this version by Don Bluth (of *An American Tail* and *All Dogs Go To Heaven*) is a crazed walk across strife-torn Europe, with garish colours, soap-bubble tunes and characters whose accents deepen the further down the cast list they go. While *Anastasia* and boyfriend Dmitri speak broad American, courtesy of Meg Ryan and John Cusack, Rasputin (Christopher Lloyd) is a Slavic snarler with an extended lease of melodramatic mortality, and Kelsey Grammer and Angela

Landbury - con man and duchess respectively - also put their vowels and consonants through the Russian mangler.

As usual with Bluth, the funny bits are barely funny at all. Worst offender is Bartok the albino bat, scripted for hectic Yiddish asides. Like his master Rasputin, he should be sent to overacting jail, or at least be fed better lines. The film's finest moments are its earliest. Pre-1916 life at the Winter Palace is depicted as a delirium of high patrician living - vast halls amid glittering chandeliers and scoops in rooms vaster and more fres-

coed than the Sistine Chapel - that suggests a combined heyday of the Sun King, Napoleon and William Randolph Hearst.

Best Men and Les Voleurs, the week's plangent sweepings, are about troubled criminals on each side of the Atlantic. In the first, four men dressed for a wedding have their day ruined when a fifth pulls a bank robbery just before the service. The movie's plot goes from mad to worse - with sheriffs, FBI men and rhubarbing crowds - while director Tamsin Davis (*Gun Crazy*) pulls off a spry, unpredictable black

comedy with much to say about male artifice. Les Voleurs has less to say but says it at greater length. A troubled cop (Daniel Auteuil), a dead brother's criminal legacy, including troubled son and Catherine Deneuve throwing herself from a window as a lesbian philosophy professor. Just when you think it can't get worse, it gets a little better. Téchiné, who made the wonderful *Les Roseaux Sauvages*, has overplotted this film. But it still has a fair complexity of character and thought, and a grace of image that can grow on you.

The mother of all Restoration comedy

THEATRE

ALASTAIR MACAULAY

The London Cuckolds
Royal National Theatre, London

Plague on thy disrespect; troth, madam; husband, I swoon... Yes, we are back in Restoration comedy land. The playwright/director Terry Johnson has adapted and revived, for the National Theatre, a long-neglected Restoration comedy, *The London Cuckolds* (1681), by Edward Ravenscroft (Gen.), in which almost everything feels familiar - familiar, at least, to anyone who has watched more than half-a-dozen Restoration comedies.

But familiarity, here, does not breed contempt. The fun of *The London Cuckolds* is its density. Three old husbands, three young wives, three young gallants: take those ingredients and now imagine the possible permutations. Often, *The London Cuckolds* seems not like an imitation of better-known Restoration comedies, but rather like their fertile mother. It has energy and inventiveness in abundance.

Only 20 minutes in, we are caught in the kind of classic farce

situation (my husband has unexpectedly returned...) which Feydeau took an hour to reach; and within the hour we have encountered two more such situations, each one ingeniously plotted and deliciously protracted. It keeps reminding us of comic situations already made familiar by playwrights from Plautus to Beaumarchais; and they are still funny.

The larger joke underpinning this series of attempted adulteries is that the most determined of the play's three young gallants keeps being frustrated - one loses count of how many times before the play ends - and never once enjoys even one of the women who encourage his advances. Meanwhile his best chum seems virtually to trip into the women's beds by accident.

Each of the wives is different (one an urbane wit, one a country innocent, one a country pious). None of this seems new, but all of it is enjoyable. Where the play is at its most original is in the extent to which the three old husbands remain in denial about the mounting evidence of their young wives' adulteries: cuckoldry proves better than facing facts.

Johnson has directed his own adaptation, and he makes no pretence that the events before us are other than theatre. We see, in William Dudley's designs, characters before their entrances and after their exits; it is peculiar how well this succeeds.

A few characterisations are more formulaic than is necessary; some of the Restoration parlance sounds more theatrically over-emphatic than is convincing or fresh; and the production - its press night had been postponed a month due to an injury to Caroline Quentin, who plays the witty wife - is now so well "run in" that a couple of its actors have learnt to milk the laughs to excess here and there. Still, the ensemble and pacing are splendid.

Quentin is, because of TV (*Men Behaving Badly*, *Jonathan Creek*), the most famous actor in the cast. She is not, however, the most experienced or accomplished; indeed, anyone who watched more than one episode of *Jonathan Creek* will have seen her recycling the same half-a-dozen tricks of voice or face. Yet *The London Cuckolds* has extended her range, and only occasionally does she fall back on her more familiar tricks. (Biting her lip on one side, like a schoolchild, is my least favourite.) Since she played Goldoni's *Mirandolina* a few years ago, she has gained in style a good

deal, and she is an exemplary colleague. Best of all, she surprises you more as the play proceeds: at times in Act Two she wields a musical authority of voice at once hilarious and impressive.

Ben Miles also reaches a new high in his career as the perpetually randy and perpetually frustrated Ned Rumble; his raffish, scampish energy - even when he exaggerates a few moments of clowning - are a constant motor to the comedy. Alexander Hanson's virile charm could not be bettered in the role of Loveday; this is an actor, Robin Soans, Sharon Small, William Chubb, and Hilda Braid are also very fine and often very fresh; and Kelly Reilly, Anthony O'Donnell, Nigel Lindsay, Sharon Bourke, Ysobel Gonzalez are all highly engaging although in more standard sorts of ways.

I prefer Restoration comedy when it is played more truthfully than this, but there are more ways than one to skin a cat. Here, as Ned Rumble falls out of the tree in which he has been hiding and flattens a duck in the pool into which he falls and then tries to restore it to life, all in a matter of seconds, you know you are watching very stock theatre indeed; and yet you laugh. I do, at any rate, heartily. And so do many more.

In National Theatre repertory at the Lyttelton Theatre, London SE1.

An intimate spell in the underworld

OPERA

LUCIANO CHIANESE

Monteverdi's *Orfeo*
Teatro Goldoni, Florence

The heavily publicised re-opening of the Teatro Goldoni in Florence after Italian unification, before experiencing a brief moment of glory this century with Federico Fellini's staging of his *I Vitelloni*. Given that Luca Ronconi's production of *Orfeo* was guaranteed to draw crowds, it came as a surprise to find half the theatre's seating capacity of 420 occupied by the stage, which covered the entire stalls. Had the performance not been so fine, such self-indulgent effects on Ronconi's part would have stolen the show.

In the event, Ronconi managed to rescue Monteverdi's early masterpiece from the starched formality into which it is liable to slip. Orpheus's descent into the underworld was particularly effective, with the inversion of trees on stage and the stalls area flooded with water to create the Styx. René Jacobs moulded the voices to a high level of delicacy, striking a balance between the solemnity of Monteverdi's sacred music and the light, airy quality of his madrigals. With the singers so close to the audience, the traditional barriers were swept away, creating an atmosphere of great intimacy.

As if conducting in two directions at once were not enough of a challenge, Jacobs opted for a full 35-instrument orchestra, including an organ and two continuo - half of them positioned in the pit and the others scattered up in the gods. The theatre was thus flooded with music from every angle.

With their predominantly Rococo backgrounds, Roberto Scaltriti as Orpheus and Cecilia Gasdia as Eurydice coped admirably with the spartan nature of Monteverdi's harmony. The purity of Gasdia's tone came out particularly well in her light, restrained ornamentation. Vibrato was kept in check by both singers, whose stylised movements were choreographed, along with the rest of the cast, in such a way that the opera itself acquired the feel of a pastoral dance.

As for the future of the Goldoni, things remain unclear. For the 400th anniversary celebrations in Florence in 1998, three Monteverdi operas are scheduled to be performed elsewhere in the city under Ronconi's direction. The consortium managing the theatre, made up of the Fiesole Music School, the Orchestra della Toscana and the city council, has not yet drawn up a programme. The question is whether the ball set rolling with *Orfeo* will gather speed, or wind up in yet another tangle of bureaucracy.

INTERNATIONAL

Arts Guide

AMSTERDAM

DANCE

Het Muziektheater
Tel: 31-20-551 8911
Dutch National Ballet: Romeo and Juliet. Rudi van Dantzig's 1987 version, created for the DNB and set to Prokofiev's score. With sets and costumes by Toer van Schayk; Mar 25; Apr 1, 2, 3

EXHIBITIONS

Stedelijk Museum
Tel: 31-20-6732911
www.stedelijk.nl
Stuart Davis (1892-1964): survey of work by the American painter often seen as a link between American modernism, abstract expressionism and Pop Art. Deeply impressed by the painters of the European avant-garde, Davis was also influenced by Afro-American jazz, and made his mark with a series of still lifes on the theme of tobacco; ends on Sunday

BOLOGNA

OPERA
Teatro Comunale
Tel: 39-51-529 999

www.netuno.it/bo/teatrocomunale

● Don Carlo: by Verdi.
Co-production with the Grand Théâtre de Genève, conducted by Elisha Indal in a staging by Andrei Serban; Mar 26, 29
● Il Campiello: by Wolf-Ferrari. New production directed by Bruno Bartoletti in a staging by Nanni Garella, with designs by Antonio Fiorentino; Mar 27, 28

CANBERRA

EXHIBITION
National Gallery of Australia
Tel: 61-2-6240 6502
www.nga.gov.au
New World From Old: 19th Century Australian and American Landscapes. 100 paintings by artists including Augustus Earle, Conrad Martens, Thomas Cole and Winslow Homer; to May 17

CHICAGO

CONCERTS
Orchestra Hall
Tel: 312-294-3000
www.chicagosymphony.org
Chicago Symphony Orchestra: conducted by Daniele Gatti in works by Brahms. With violin soloist Samuel Magard; Mar 26, 27, 28

HELSINKI

EXHIBITION
Museum of Foreign Art, Sinebrychhoff
www.mfg.fi
Luxury: Gold and Jewellery of Pompeii. 150 items including pendants, rings and bracelets, displayed to mark the 250th anniversary of the beginning of the

excavations; to May 31

LONDON

CONCERTS
Queen Elizabeth Hall
Tel: 44-171-960 4242
● The Tchaikovsky Experience: Roger Norrington conducts the Orchestra of the Age of Enlightenment in a weekend of concerts, using period instruments, intended to sound as historically accurate as possible. Saturday's programme includes extracts from Sleeping Beauty and Piano Concerto No. 1, with pianist Cyril Huvé. Sunday's programme includes Tatyana's Letter from Eugene Onegin with soprano Joan Rodgers, and the Pathétique Symphony. The weekend's activities include afternoon recitals by Huvé and Rodgers, as well as talks and open rehearsals
● Opera North: concert performance of Sondheim's Sweeney Todd, with the English Northern Philharmonia, conducted by James Holmes; Mar 30

Royal Festival Hall
Tel: 44-171-960 4242
● Philharmonia Orchestra: conducted by John Eliot Gardiner in works by Elgar, Sibelius and Brahms. With violin soloist Gidon Kremer; Mar 26
● Philharmonia Orchestra: conducted by John Eliot Gardiner in works by Elgar, Chopin and Dvorak. With piano soloist Maria Joao Pires; Mar 30

OPERA
English National Opera, London Coliseum
Tel: 44-171-632 8300

● La Bohème: by Puccini. Steven Pimlott's production is revived by Barry Atkinson and Frances Moore, and conducted by Emmanuel Joel (Mar 26/Alex Ingram (Mar 27)
● The Tales of Hoffman: by Offenbach. New production by Graham Vick, designed by Tobias Hoheisel and conducted by Paul Daniel/William Lacey. Cast includes John Tomlinson; Mar 28

Sheffield Theatre

Tel: 44-1773-379 6399
The Royal Opera: Così fan tutte, by Mozart. Festival of Jonathan Miller's production, conducted by Colin Davis (David Syrus on 27 Mar); Mar 26, 27, 28

MADRID

EXHIBITIONS
Fundació "la Caixa"
Tel: 34-1-435 4833
1898, Fin de Siècle Spain: Daily Life. Historical exhibition designed to reconstruct a picture of life in Spain at the end of the last century. Includes books and newspapers as well as paintings; ends on Sunday, then transfers to Barcelona

NARA

EXHIBITIONS
Nara National Museum
Highlights of Asian Painting from Cleveland's Museum of Art: selection of 100 works from the 11th-19th centuries, from the CMA's holdings of Chinese, Japanese, Indian and Korean art; ends on Sunday

NEW YORK

OPERA

Metropolitan Opera, Lincoln Center

Tel: 1-212-368 6000
www.metopera.org
● L'Elisir d'Amore: the final performance of the season is conducted by Maurizio Benini, with a cast including Ruth Ann Swenson; Mar 26
● Stiffelio: conducted by James Levine, with Maria Guleghina as Lisa and Plácido Domingo as Stiffelio. The production is by Giancarlo del Monaco; Mar 27

New York City Opera, New York State Theatre

Tel: 1-212-870 5570
www.nyco.org
La Bohème: by Puccini. Production conducted by George Manahan and staged by Grazzielle Sclitti; Mar 26, 28

PARIS

CONCERT
Salle Pleyel
Tel: 33-1-4561 6589
Orchestra de Paris: conducted by Paul Daniel in works by Mendelssohn, Berlioz and Rachmaninov. With mezzo-soprano Vessellina Kasarova; Mar 26

EXHIBITIONS

Musée Carnavalet
Tel: 33-1-4272 2112
Charmant showcase of objects made by the Parisian jeweller, from the age of Napoleon to the present. Where possible, portraits of the owners wearing them are shown alongside the jewels themselves. Highlights include the extravagant parures - matching sets of tiaras, necklaces, earrings and bracelets - created for 19th century European aristocrats; to

Jun 28

ROME

EXHIBITIONS
Villa Medici
Francesco Salviati: 1510-1563. First major retrospective devoted to Salviati, one of the lesser known Florentine Mannerists. Includes around 135 works. For the duration of the exhibition, there will be guided visits to see his frescoes, the most spectacular of which is in the French Ambassador's study; ends on Sunday

ROTTERDAM

CONCERTS
de Doelen Hall
Tel: 31-10-217 1700
Rotterdam Philharmonic Orchestra: conducted by Valery Gergiev in works by Debussy, Mussorgsky and Prokofiev. With baritone Dmitri Hvorostovsky; Mar 27

SAN FRANCISCO

CONCERTS
Davies Symphony Hall
Tel: 1-415-584 8000
www.sfsymphony.org
San Francisco Symphony Orchestra: Herbert Blomstedt conducts Bruckner's Symphony No. 5; Mar 26, 27, 28

TOKYO

CONCERT
Bunkamura
Tel: 81-3-3477 9999
Tokyo Philharmonic Orchestra: conducted by Kazushi Ono in a concert performance of Janáček's

Janáček. With the Tokyo Opera Singers; Orchard Hall; Mar 26

EXHIBITIONS

Metropolitan Art Museum
Tel: 81-3-3823 6921
Masterpieces of British Art from the Tate Gallery: 100 works on loan from London, ranging from the 16th century to the contemporary; ends on Sunday

WASHINGTON

CONCERTS
Kennedy Center
Tel: 1-202-487 4600
National Symphony Orchestra: conducted by Erkki Kias in works by Mozart, Stravinsky and Saint-Saëns; Concert Hall; Mar 26, 27, 28

TV AND RADIO

● WORLD SERVICE
BBC World Service radio for Europe can be received in western Europe on medium wave 648 kHz (463m)

EUROPEAN CABLE AND SATELLITE BUSINESS TV

● CNN International
Monday to Friday, GMT:
06:30: Moneyline with Lou Dobbs
13:30: Business Asia
19:30: World Business Today
22:00: World Business Today Update

● 08:20 Tanya Beckett of FTTV reports live from LFFE as the London market opens.



PETER MARTIN

Grin without a cat

Cendant's plans for National Car Parks illustrate the growing trend towards the creation of dematerialised businesses

"All right," said the Cheshire Cat; and this time it vanished quite slowly, beginning with the end of the tail, and ending with the grin, which remained some time after the rest of it had gone.

"Well, I've often seen a cat without a grin," thought Alice; "but a grin without a cat! It's the most curious thing I ever saw in my life!" — Lewis Carroll, *Alice in Wonderland*

On Monday, a company no one has ever heard of spent \$3.1bn buying an insurance company and \$200m on a carpark operator on two different continents.

Cendant's simultaneous purchase of American Bankers Insurance of the US and National Parking Corporation of the UK rests on somewhat flimsy business logic.

Henry Silverman, Cendant's chairman, says the aim of the acquisitions is to provide his company's well-oiled marketing machinery with new products to sell to its existing customers. "When the same customer pays you more, there's no cost to that," he said. "All of that goes to the bottom line."

Perhaps — though the opportunities to cross-sell carparking spaces in Manchester to customers of Cendant's Coldwell Banker real estate brokerage in Florida must surely be limited.

Cendant may be a company in too much of a hurry. It took its present form only in December 1997 with the merger of two obscure service-business conglomerates, CUC and HFS. Still, it illustrates a powerful force in modern business.

This is not — pace Mr Silverman — the opportunity to cross-sell different types

of services to the same customers. That business practice was already a cliché when Elizabethan barbers first started pulling teeth and amputating limbs.

No, the genuine business innovation, which Cendant illustrates perfectly, is the dematerialisation of the company. Like Lewis Carroll's Cheshire Cat, the physical underpinning is vanishing, leaving only the distinctive mark — the brand, the grin — behind.

Hotel management, one of Cendant's key businesses, shows how this works. At one time, big hotel chains owned their own properties. Now the hotels are owned by outside investors, but managed by the chain that provides the name. Some brands — such as Cendant's Howard Johnson motels — go further, by franchising out management as well.

National Car Parks, the carparking brand that Cendant is buying in the UK, also illustrates the trend. It was founded by two men who bought up British bomb sites cheaply after the

second world war. It was as much a property company as a service business. Nearly three-quarters of NCP's sites in the UK are owned or on long leases.

Cendant has no interest in property; it is likely to dispose of most of the sites. Instead, it will focus on the immaterial aspects of the business. The most valuable of these is the brand and the management system that backs it up to ensure adequate service. Cendant hopes to extend this to car parks owned by others; and to deepen it by cross-selling other services.

Service businesses are obvious candidates for dematerialisation, though some manufacturing businesses, especially in the computer industry, have followed the same route. But service businesses have an edge: they only need physical assets at the delivery point, and can farm that part of the value-chain out to others.

Indeed, some service businesses can even retreat from providing the service

itself. As Vidal Sassoon has shown, you may not be able to export a haircut, but you can export the intellectual property in a haircut: the shape, the experience, the look and feel of the salons, the brand name. Exporting a haircut is an object lesson in dematerialisation. The business's creator withdraws from physical contact with the customers, but retains a big chunk of the value added.

The difference from conventional outsourcing lies in the attitude of the company's management. Outsourcing takes the business as it is, and asks which parts can be hived off to other suppliers. Dematerialisation looks forward and says: how can we recreate this business weightlessly, retaining the parts that generate the real wealth?

That requires a clarity of analysis that most companies don't possess. For a start, the really valuable skills may not be the obvious ones, and they may be deeply unglamorous — motivating low-paid workers, say, or dealing patiently with municipal bureaucracies. They may be so tangled up with the rest of the business processes that they are hard to identify separately.

Just as difficult, the value of a dematerialised business rests heavily on the customer perception of the brand, and its umbilical link to the management processes that stand behind it. Many companies exaggerate the true value of their brand to customers, or do not fully understand how to protect it with external promotion and internal reinforcement.

So dematerialisation is a trend that's easy to spot, hard to exploit. And, as the Cheshire Cat could have told you all along, you have to go about it in the right way.

"Would you tell me, please, which way I ought to go from here?" said Alice.

"That depends a good deal on where you want to go to," said the Cat.

"I don't much care where," said Alice.

"Then it doesn't matter which way you go," said the Cat.

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LETTERS TO THE EDITOR

US capitalism: a model worthy of emulation

From Mr Allan Wendt

Sir, John Gray raises the spectre of the American capitalist dream turning into a nightmare (*Personal View*, March 23) and, with some justification, takes US policymakers to task for over-confidence and triumphalism. Yet his many thoughtful arguments would be more convincing if he offered a realistic alternative to the American model.

The whole world is moving towards market capitalism if only because no better system has been identified, even though many have been tried. Yes, in the US there are winners and losers and inequalities and failures in public policy. But these problems exist in all systems. Winners and losers are the price that has to be paid for a system that, by all evidence, yields the greatest good for the greatest number. Europe (though not the UK) has tried to find a middle ground, and the result is sclerotic economies, low job creation, and record high unemployment.

Professor Gray really goes off the deep end when he

attributes America's relatively low employment in part to mass scale incarceration. He assumes that all those incarcerated would otherwise be jobless. Surely most would be engaged in some kind of economic activity — even if illegal (this is not to condone America's high rate of violent crime against persons). But, in economic terms, such activity is not fundamentally different from widespread corruption in developing countries and the huge grey market in Europe aimed at tax evasion.

On the latter point, does the relatively high incidence of tax evasion by Europe's rich suggest serious social inequalities? Voluntary tax compliance is a good indicator of citizens' perception of fairness in a free society.

Here again, the American model (though not the egregious Internal Revenue Code itself) may be worthy of emulation in Europe.

Allan Wendt, 3234 Volta Pl NW, Washington DC 20007-2731, US

Advent of the euro offers opportunity for change

From Mr Chris Ogden and Mr Paul Bradish

Sir, Lord Cobbold's view of the opportunity that the euro presents to commercial banks (*Letters*, March 23) is timely. Much of the debate so far has been on the difficulties the euro presents to UK business. Lord Cobbold rightly points out the opportunity side of the equation. However, businesses need to incorporate several other aspects of change into their euro planning.

The first is the internet. The average citizen will not become properly aware of the euro until notes and coins are introduced in January 2002 — four years from now. Four years is a long time in the evolution of the internet. By then, online commerce will have made important advances, and secure business-to-business and personal transactions over the internet using standard protocols will have become commonplace.

The second is the technology of payments. So-called "smart cards" will by then have become much more powerful, incorporating sig-

nature verification to combat fraud, currency conversion, and personal identification. Electronic cash technologies on the internet will, among other opportunities, enable small denomination payments to become economically viable.

It was an interesting coincidence that the same *Financial Times* carried a story in *Inside Track* ("The textbook that took off pre-launch") on a new book on finance by Robert Merton and Zvi Bodie. Their innovative thinking will be seen as signalling a sea change in the way financial products and services are designed. It is clear that planning for the opportunity side of the euro needs to be given a much wider context if businesses are to reap the benefit.

Chris Ogden, director, Future Business Lab, Paul Bradish, director — Euro Services, DMR — a division of Amdahl, Heathrow Boulevard IV, 280 Bath Road, Middlesex UB7 0DQ, UK

Swiss aim is European truck agreement to protect Alps

From Mr François Nordmann

Sir, I refer to your article, "Swiss move towards truck charges system" (March 19). The Alpine region is under grave threat from the increase in road traffic. Switzerland has taken draconian measures to transfer Alpine transit traffic from road to rail. In exchange for the prohibition on trucks over 20 tonnes, it has undertaken to construct two trans-Alpine rail tunnels for the trains which will, from 2005, transport trucks from Basle to Chiasso or vice versa.

To regulate the situation in the intervening period, an agreement was reached on

January 23 1998 between Switzerland, the European Commission and the EU presidency. Switzerland will progressively accept trucks of more than 26 tonnes but will impose a fiscal levy fixed at Ecu200 (Sfr325) on average, ie about £130. This agreement was to be approved by the member states as part of the body of texts produced in the sector negotiations which have been proceeding between Switzerland and the EU since December 1994. Following the strong objections of one of the member states, it was not possible to reach a favourable decision at the council of the ministers of

transport on March 17. But the text of the agreement was accepted by a very large majority of states, with some expressing certain reservations. Switzerland considers that the EU needs more time to ratify the work of its negotiators — but the text remains on the council table. Even if the treaty could have been definitively adopted, Switzerland would have brought into force fiscal measures for all trucks travelling on the Swiss road network (and not just in the Alpine region), as agreed in the treaty of Porto between Switzerland and the EU.

Your correspondent speaks of a "collapse" in the

negotiations — which is manifestly wrong — and prescribes Switzerland as if it were about to react by going it alone, which is not correct either. The negotiation will continue in the five other sectors which it covers and the ministers of transport will examine the issue again. The idea that one of them could lose elections if he approves the deal negotiated by Neil Kinnock, EU transport commissioner, is too ugly to contemplate.

François Nordmann, ambassador, Swiss Embassy, 165-18 Montagu Place, London W1H 2BQ, UK

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INVITATION

For submission of offers for the purchase of shares in the BANK OF MACEDONIA AND THRACE S.A. of Thessaloniki, Greece

The POST SAVINGS BANK, the NATIONAL INVESTMENT BANK FOR INDUSTRY & DEVELOPMENT S.A., the NATIONAL BANK OF GREECE S.A. and the ETHNIKI KEFALAIOU S.A. ADMINISTRATION OF ASSETS & LIABILITIES (the "Sellers") announce their intention to sell two million three hundred sixteen thousand three hundred and seventy two (2,316,372) common registered shares (the "Shares") in the BANK OF MACEDONIA AND THRACE S.A. (the "Bank") which represent 36.98% of its share capital.

To this end the Sellers invite prospective buyers to submit offers for the shares (the "Offers") according to the following:

The Bank

The Bank was established in 1979 and is based in Thessaloniki. Today, its share capital amounts to GRD 6,696,520,000 divided into 6,264,000 common registered shares each having a nominal value of GRD 1,056. All shares are listed on the Athens Stock Exchange.

The Bank performs all banking activities as determined by the Greek Banking Law. According to its Articles of Association its activities should focus on the development of the regions of Macedonia and Thrace.

A brief description of the Bank and its activities is included in a relevant Memorandum (the "Offering Memorandum"). Interested parties may receive a copy of the above Memorandum together with a full file of information regarding the Bank activities from the Sellers Agent (as stipulated in paragraph 9), upon signing of a confidentiality letter.

Terms and Procedures

1. **Applicable Regulations:** The procedure for the submission of the Offers and the transfer of the Shares will take place according to the Resolution of the Board of the Athens Stock Exchange taken on 19 February 1998 as amended by the Resolution of the Board taken on 19 March 1998 (the "Resolution of the Board of Athens Stock Exchange") and also according to this invitation and the Offering Memorandum. By submitting an Offer prospective buyers are deemed to have fully accepted all such terms and conditions.

2. **Submission and Contents of the Offers:** The Offers must be submitted according to the Resolution of the Board of the Athens Stock Exchange and the following conditions:

- The Offers must be submitted to the Board of the Athens Stock Exchange on the 10 April 1998 from 14:00 to 15:00.
- The Offers should be made for the whole lot of the offered Shares otherwise they will be rejected. Evidently, due to the nature and the conditions of the procedure this invitation is addressed only to investors who act in the context of their professional/business activities and not to the general public.
- The total value of the Shares should be paid in cash upon the transfer of the Shares.
- All Offers should be accompanied by a confirmation of a Bank operating in Greece stating that the prospective buyer is able to pay for the value of the Shares. The above confirmation is not required if the prospective buyer is a Bank.
- The Offers should not contain any terms, conditions, reservations or dubious expressions which may create ambiguities in respect of the offered price or other matters relevant to the sale.
- The submission of improved or competitive Offers is prohibited.

3. **Additional Conditions:** The transfer of the Shares will be made under the condition that the buyer will be bound to comply for a period of two (2) years with the following conditions:

- Not to vote in favour of the change of the name of the Bank.
- Not to vote in favour of any proposal for the merger or the acquisition of the Bank by another entity.
- Not to transfer the acquired Shares.
- To preserve the existing employment (jobs).

To this end the buyer will sign a separate agreement. A draft of this agreement may be obtained from the Sellers' Agent as stipulated in paragraph 9.

4. **Approval and Acceptance of the Offers - Transfer of the Shares:** The Sellers will appraise the Offers and shall have the right, to their absolute discretion, to accept or to reject any Offer as provided for in the Resolution of the Board of the Athens Stock Exchange. The acceptance of an Offer will be concluded upon notification (through a ballot or by confirmation of receipt) of the official written acceptance which will also provide for the date of the transfer of the Shares. Furthermore, a relevant announcement will be published according to the Resolution of the Board of the Athens Stock Exchange.

The transfer of the shares will be effected on the Athens Stock Exchange through a manual block transaction (outside the automated exchange trade system) involving one or two brokerage firms according to the particular procedure that will be specified in the aforementioned notice.

5. **Approval of the Government's Privatization Committee:** The sale of the Shares is made according to the Resolution of the Government's Privatization Committee taken on 19.2.98.

6. **Approval of the Bank of Greece:** Prospective buyers should obtain the approval of the Bank of Greece in order to acquire the offered Shares.

7. **Approval of the Competition Committee:** Prospective buyers should, if necessary, obtain the approval of the Competition Committee.

8. **Declaration of the Sellers:** The Sellers declare that they do not possess any other Shares of the Bank of any voting rights as defined by Article 7 of presidential Decree 51/1992.

9. **The Sellers Agent:** For any communication or information or receipt of documents the Sellers designate as their representatives Mr. H. Horarias, Manager of the National Bank of Greece, Domestic Affiliates Division (address: 5, Karagorgi Is Services Str., 5th floor, tel.: +30-1-334.0391, fax: +30-1-334.0396) and/or Mr. C. Cionese (same address, tel.: +30-1-332.0323, same fax). Interested parties may contact the Sellers' representatives in order to receive the draft of the agreement mentioned in paragraph 3 above and a copy of the Offering Memorandum after signing a confidentiality letter.

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PERSONAL VIEW TOM PETRI AND BERT ELY

A way out of bad banking

A private guarantee system for banks would have the benefits of current government supervision without its costly drawbacks

Government oversight of individual banks is not working.

In order to maintain the health of the banking system and to forestall losses to depositors, governments stand ready to support big banks against failure. There are advantages: this helps ensure the uninterrupted operation of the payments system and the smooth functioning of financial markets. But there is a serious drawback. By offering protection against the consequences of bad banking, government regulation helps inadvertently to encourage it.

Because of this protection, loan interest rates do not incorporate a sufficient risk premium. Hence, uneconomic projects are too easily financed, fostering speculative bubbles that inevitably burst. And when banking crises do occur, taxpayers must ride to the rescue.

The political reality is that many banks, as well as entire banking systems, are simply too big to fail. Yet their rescuers are not paid in advance for the risks they bear because government regulatory monopolies cannot properly price risk. Worse, this risk is not reflected, before the fact, in interest rates.

The frequency and growing magnitude of banking crises calls into question the conventional wisdom that only governments should supervise individual banks. After all, competitive markets produce better outcomes than government monopolies.

Moreover, one-size-fits-all rules, such as the Basel risk-based capital standards, restrict banking strategies. This in turn fosters banking homogeneity and the herd instinct that often leads to crisis.

Hence it is legitimate for governments to want sound banking in order to ensure systemic stability. And that task is increasingly important. As technology integrates banking with insurance and securities activities, the problems of systemic banking risk expand to encompass entire financial systems.

However, it is not axiomatic that public officials must directly ensure sound banking on a bank-by-bank basis. Private-sector companies and individuals who place their own capital at risk will be much more diligent in pricing and monitoring bank insolvency risks (which they have voluntarily assumed) than government bureaucrats, who do not have wealth at stake and who are rarely fired even after banking crises.

In principle, the idea of a "narrow bank" might address these concerns. Narrow banks would protect depositors and the payments system by investing only in very safe assets, such as government bills and high-grade commercial paper. Other forms of banking would be unprotected. This, though, would merely shift banking

As cross-guarantees would utilise market forces to produce superior banking performance, market forces would govern their expansion

risk elsewhere in the financial system, continuing to expose governments to systemic risks.

We therefore propose a new division of responsibilities between government and the private sector. Governments should remain responsible for ensuring systemic stability and for devising a mechanism to achieve that goal. But governments should delegate the supervision of individual banks to a new "cross-guarantee" system.

Under this system, an individual bank would negotiate a prudential regulatory contract with an ad hoc syndicate of voluntary guarantors, largely other banks. They would guarantee against loss all of the bank's deposits and other sources of funding, regardless of the currency in which that funding was denominated.

In return, the guarantors would receive a negotiated, risk-sensitive premium frequently adjusted to reflect changes in the guaranteed bank's riskiness. Premium formulas would be based on

leading indicators of banking risk, such as exposure to emerging speculative bubbles. Competitive pressures would force the inclusion of these premiums in loan interest rates, thus inhibiting the formation of bubbles.

A private-sector "syndicate agent", selected by mutual agreement between the guaranteed bank and its guarantors, would monitor the bank's compliance with contractually specified prudential practices tailored to its business strategy.

So as to ensure systemic stability and to avoid Lloyd's-type problems, each cross-guarantee contract would have to conform with government-enforced risk dispersion rules. These would not be designed to prevent bank failure, since that would be the guarantors' responsibility. Instead,

it would be to ensure that all bank insolvency losses were borne within the universe of guarantors. Closure of a failing bank would lie with its direct guarantors.

US Congress has before it legislation that specifies these risk-dispersion rules in detail. These rules also would permit the cross-guarantee system to act as its own lender of last resort.

This proposal would, in effect, privatise banking regulation. It may seem radical, but the irreversible impact of technology on financial services demands a change in regulatory philosophy. Existing government deposit insurance schemes have many elements of the cross-guarantee concept. Our proposal merely privatizes these schemes.

Market forces harnessed through freely negotiated contracts can transcend traditional industry boundaries as well as nation-state borders. A cross-guarantee contract, enforceable in a reliable jurisdiction, could encompass all of the liabilities and financial commit-

ments of a globally active financial conglomerate. Hence, the cross-guarantee system could evolve into a global regulatory mechanism accommodating financial institutions of all kinds and sizes, whether operating locally or worldwide. Government supervision can never meet this challenge.

Due to its risk dispersion rules, the cross-guarantee system could not start with just a few institutions. It would require a large pool of banks. But it would not be necessary to mandate the system for all institutions. Instead, it could be authorised for a large market, such as the US or European Union, and then launched once 250 institutions voluntarily obtained cross-guarantee contracts.

Thereafter, in competition with existing regulatory schemes, cross-guarantees would grow as individual institutions obtained contracts. Increased numbers would further strengthen the cross-guarantee system's capacity to absorb shocks far worse than the Great Depression. However, just as cross-guarantees would utilise market forces to produce superior banking performance and systemic stability, market forces would govern their expansion.

We assume that private supervision would be more attractive for banks than government supervision. But if we were wrong, no banks would opt for it, the cross-guarantee system would never get off the ground, and nothing would be lost.

If it did get off the ground, though, there is much to gain. Technology has undermined the regulatory controls over financial institutions. In the interest of economic efficiency and systemic stability, governments should try market-based regulatory mechanisms. The cross-guarantee system meets that need.

Mr Petri is a member of the US House of Representatives from Wisconsin. Mr Ely is a financial institutions and monetary policy consultant in Alexandria, Virginia.

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FINANCIAL TIMES

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Thursday March 26 1998

The verdict on Emu members

An Emu of 11 member states is now just a hair's breadth away. The European Commission's convergence report yesterday concluded that all 11 candidates had met the Maastricht convergence criteria. The report of the European Monetary Institute, though more cautious, did not contradict this recommendation. But this was no great surprise. The question now being asked by Europe's policymakers is whether the convergence will be sustainable.

Over the past few years, Emu hopefuls have run their economic policies with Maastricht in mind. The result has been dramatic: a fall in the average EU fiscal deficit from 8.1 per cent in 1993 to 2.4 per cent in 1997. The question is whether this restraint will continue – or whether, once countries have achieved the goal of entering Emu, policy coordination will fizzle out. The answer to this question is the key to whether Emu will succeed.

When it comes to the question of sustainability, the reports of the Commission and the EMI diverge considerably. This reflects the different nature and aims of the two institutions.

The European Commission, the EU's civil service, has played a key political role in the construction of monetary union. It is desperately keen to push the project along, and so it is unsurprising that its report takes an optimistic viewpoint. It raises no doubts, for example, about the commitment of the Italian government to carry out the fiscal reforms that it has promised over the coming years.

The European Monetary Institute stands more aloof from the process – and has a central bank's natural caution. Its report is far more revealing about the challenges that lie ahead. And its message is strong: the adjustment efforts of previous years need not only to continue, but need to be taken much further.

Colossal task

Europe's high-debt countries face a colossal task if they are to bring their debt ratios down to the 60 per cent Maastricht level. Italy, for example, would have to run a budget surplus of 3 per

cent of GDP a year to reduce its debt ratio to 60 per cent by the year 2007. Realistically, debt reduction will not happen so quickly. But while the debt ratios of these countries remain high, they will be in a very uncomfortable position – under pressure from their peers to reduce their debt as quickly as possible, with very little room to manoeuvre in case of domestic economic difficulties.

Fiscal policy

And the high-debt countries are not the only ones who will find their fiscal policies constrained by monetary union. Governments will need to have the capacity to use fiscal policy to respond to difficulties without breaching the fiscal limits imposed by the Stability Pact. Emu itself will impose strains that will need a fiscal response – greater competition, for example, could push up unemployment in some countries. And, in the longer term, many governments are facing huge burdens on expenditure because of demographic trends.

To get this flexibility, countries will need to aim for a budget close to balance over the economic cycle. Many of Emu's potential members, including France and Germany, are a long way from this aim.

Whether co-ordination of fiscal policy will happen is a question of politics, not economics. Member states are only just coming to accept that, while individual tax and expenditure matters remain national decisions, the logic of Emu requires that the overall fiscal stance must be determined by the aim of economic stability in the whole single currency area.

The moral pressure to bow to the interests of Europe will be strong, as the Maastricht process has shown. But even with the backing of the Stability Pact, peer pressure may not be enough to achieve the degree of fiscal consolidation that is needed to make Emu work. Governments must accept – permanently – the constraints that Emu will place on domestic policy-making. No report can predict whether this is going to happen.

China reforms

When European Union leaders meet Zhu Rongji, China's prime minister, in London next week, they will applaud his bold economic reform plans. But they will also warn him firmly that these must not distract attention from the goal of joining the World Trade Organisation.

Western concern has been aroused by China's recent reluctance to make good on promises of trade liberalisation. Its hesitation may be temporary and reflect recent political changes at the top. But Beijing also seems worried that the upheavals involved in restructuring its economy, above all the banking sector, could be even more severe if it opens its market too hastily to foreign competition.

The argument deserves sympathy. But China needs clearly to

recognise that internal reform is a step towards – not a substitute for – eventual integration with the global economy. The crucial question is how the two processes are to be synchronised.

The EU has offered to allow China to open its services market in stages after it joins the WTO, provided it commits itself to agreed deadlines. Brussels has also sought to reassure China that it is acting in good faith, by spelling out more precisely its basic terms for WTO entry.

China should be encouraged to respond by proposing a realistic liberalisation timetable. Its incentive to do so would be increased if the EU unequivocally endorsed the EU initiative. Beijing is more likely to listen to messages from the west if they are spoken clearly, with one voice.

UK utilities

Britain's privatised utilities are entering a period of upheaval. The introduction of retail competition in gas this year and later in electricity will reduce the need for regulation. This has already happened in telecommunications, leaving only the water companies as traditional monopolies.

The government's consultation paper yesterday on the reform of utility regulation gave welcome encouragement to the process. It was not always clear that a Labour government would understand that as competition increased regulation would become less important to consumers – and to the government.

With some exceptions, this green paper passes that test. It would preserve the broad structure of UK regulation and many of its special features, such as "RPI-X" price regulation. It accepts that profits are an important spur to efficiency. Labour's previous ideas in opposition for confiscating "excess" profits have been very much softened.

The main theme, reflected in the title, is to give more explicit importance in the law to the protection of consumers. And statutory consumer councils would be established to work alongside regulators. These changes may be more apparent than real. At

present, all regulators regard consumer protection as the core of their job, and they work closely with consumers' representatives, albeit less formally than now envisaged. However, problems could arise if consumer councils, appointed by ministers, became, in effect, antagonists to the regulators, and eroded their position as consumer champions.

The other main constraint on regulators' powers would be "statutory guidance" offered by ministers once every five years or so, on social and environmental policy. This is a bad idea, but it seems to have been watered down enough to do little damage. Most of the other suggestions represent a necessary tidying up, with welcome moves to greater transparency. A merger of gas and electricity regulation is overdue as the two industries converge. Proposals to support regulators with a board of statutory advisers would only institutionalise present arrangements. Replacing single regulators with a tri-umvirate could work. But the third option of a US-style commission should be resisted as far too cumbersome. There is plenty of work still to be done, but taken together these proposals will do little harm, and maybe some good.

George Soros could be forgiven for experiencing an identity crisis. Portrayed last year by Mahathir Mohamed, Malaysia's prime minister, as a "parasite" who undermined currencies and destabilised local economies, the New York-based financier has now emerged as a saviour of bankrupt Asian enterprises.

This month, Mr Soros headed a consortium investing \$650m in a faltering Thai steel mill. That one transaction is eight times larger than last year's total merger and acquisitions activity involving a target company in Asia.

Moreover, Mr Soros is only part of what may prove a historic trend: US investors, rather than running scared in a crisis, are seizing the opportunity to deepen their involvement in the troubled tiger economies. In the process, they could help reshape corporate Asia and deepen US long-term political engagement in the region.

Many US companies have been frustrated in the past by their inability to access the vast, growing Asian consumer, business and industrial markets. But this is all changing rather dramatically, as the Asian M&A markets begin to open, says CS First Boston, the investment bank.

At the moment, the US impact in Asia has been greater at the level of international relations than on corporate culture. In the case of US relations with China, the Asian crisis has already had an effect. Beijing's pledge to avoid a competitive devaluation has been welcomed in Washington as evidence of China's growing maturity as an emerging economic power. President Bill Clinton's visit to China this summer seems certain to increase co-operation between the two countries, based largely on their mutual concern about Asian economic stability.

It is not only China. US engagement with other Asian countries has also been reaffirmed in the wake of the turmoil, largely through US leadership of international rescue operations in the region. This has not necessarily made relations more harmonious. Washington did not endorse itself to President Suharto of Indonesia by pressing vigorously for reforms. But even in Jakarta, the significance of the US relationship has increased.

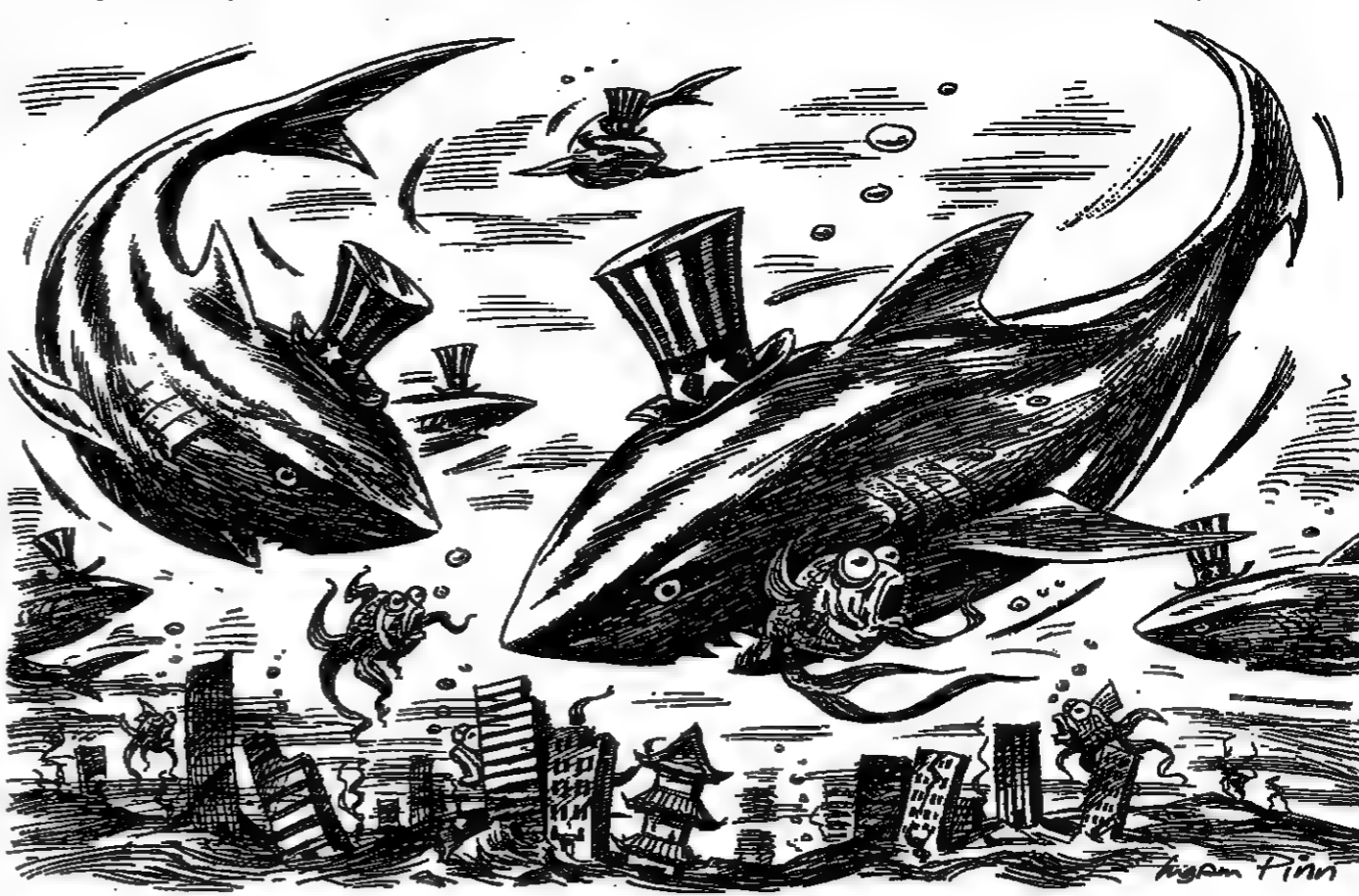
Western analysts are cautious about predicting a lasting and irreversible shift in US corporate and political involvement in the region. There are limitations on western abilities to influence a patchwork of economies, all at different stages of development and responding in different ways to crisis. Japanese resistance to US pressure to introduce a fiscal stimulus package is one indication of these limits. Indonesia's reluctance to come to grips with its predicament is another.

All the same, at the corporate level, as at the political one, the pressures and the penetration are increasing. "There is no question we are seeing an acceleration of corporate involvement in Asia, especially among those companies who already have a presence there and who see opportunities which fit into their business plan," says Robert Horowitz, top Asia strategist at Goldman Sachs, the investment bank.

East Asia's demand for fresh capital to clear up bad loans is providing western institutions

Snapping up bargains

The wave of foreign investors, particularly from the US, after the recent financial turmoil in the region could help reshape corporate Asia, say Tony Walker and John Ridding



with unprecedented leverage. The conditions attached to International Monetary Fund and World Bank rescue programmes are playing a role in prising open Asia's closed corporate cultures, creating opportunities for international companies.

"The opportunity for investment, whether in production, distribution or portfolio assets, is once-in-a-lifetime," says Adlai Stevenson, a former US senator and president of SC&M International, a Chicago-based merchant bank.

"With low bond ratings and depressed stock markets acting as significant barriers to capital raising, Asian companies are being forced to pursue all alternatives," argues CS First Boston. These are to "undertake the sale of non-core assets or seek an infusion of cash from abroad in the form of a joint venture or sale of a significant stake."

US companies are moving to seize opportunities. Much of the action has been concentrated in countries that have gone furthest in implementing IMF and World Bank measures aimed at achieving transparency in their economies and improving corporate governance. Thailand and South Korea have topped the list.

The list of deals concluded since the crisis emerged in the middle of last year runs the gamut of business, from American Insurance Group's buyout of a Thai finance house to the big automotive and electronics groups. Delphi Automotive, the components subsidiary of General Motors, is weighing up the acquisition of its largest Korean counterpart. Intel, the US microprocessor manufacturer, has been seeking to expand co-operation with Samsung Electronics.

The main focus, however, has been to finance a sector that has traditionally proved to be the least accessible to international investors. That is changing under the pressures unleashed by the region's upheaval and by the demands of structural reforms, especially in the biggest markets of Japan and Korea.

Merrill Lynch, the US investment bank, is spending \$300m to buy part of the brokerage operations of bankrupt Yamachi Securities, exploiting a long-awaited opportunity for US finance houses to break into the closed Japanese market. GE Financial Assurance, a unit of GE Capital, is also seeking to profit from Japan's troubles by forming a \$1.15bn joint venture with Toho Mutual, Japan's 12th largest life insurer, which was on the verge of collapse. The deal, which gives GE control of the new venture and protection from the liabilities of the old Toho, is extremely favourable.

"A transaction on such terms would have been unheard of prior to the crisis, when most Asian companies saw little need or desire to cede control to secure capital," says CS First Boston.

Coca-Cola, the soft drinks company, and Procter & Gamble, the consumer products group, are among other prominent US companies that have moved quickly. Coca-Cola recently paid \$44m for the bottling unit of Doosan Group, its Korean partner, while Procter & Gamble bought Seangyong Paper from the Seangyong conglomerate.

Companies such as Coca-Cola and P&G are well established in the region and already had target companies identified as part of a business plan. They have tended to be among the first wave of "bottom fishers" – that is, people

hoping to snap up bargain-basement deals. Mr Soros and other, more opportunistic investors are comparatively new to the region. They represent a second wave that is now stirring.

"The first phase, which is well under way, concerns those companies who already know their targets," says the head of corporate finance at one regional investment bank. "The next phase, which is beginning to stir, involves new players."

The inflows of foreign capital are putting pressure on management practices, and hence could change corporate culture in Asian countries. A landmark was passed last week when SK Telecom, one of Korea's biggest mobile telecommunications manufacturers, yielded to pressure from a group of foreign shareholders led by Tiger Management, a US hedge fund. SK Telecom agreed that two outside directors could be appointed as directors, the first time overseas investors have gained representation on the board of a Korean chaebol, or conglomerate.

"In itself it sounds like a small step," said one Hong Kong-based fund manager. "But it is a measure of how far the environment has changed. Six months ago, the idea of foreign investors pushing through these kinds of changes would have been fiction."

How much further these changes extend, and to what extent US companies reap the rewards, remain big questions. Many obstacles remain.

Among the general problems are lingering risks with investments and a potentially limited window of opportunity. Although investment bankers in the region are optimistic about the potential for mergers and acquisitions and the extension of international business interests, they are also cautious.

They have two contradictory worries. One is that things have not settled down sufficiently. "We are quite a long way from understanding the full extent of the difficulties in the corporate sector in all of these countries,"

says Mark Dowling, head of corporate finance at Jardine Fleming, the Hong Kong-based investment bank. "So it is a very brave move now with almost unlimited downside. To wait is not a risky strategy."

The other is that the door could slam shut. "There is probably a window of 12 months," says Bob Broadfoot, managing director of political and economic risk consultancy in Hong Kong. Within that time, he believes, the strong will have ensured survival and the weak will have perished.

"I have two big concerns," says the regional chief executive of one US bank. "One is if Korea and Co think they have turned the corner and slam the door shut again. The other is if these economies don't recover and plunge into social upheaval. Then international investors are going to become the focus of anger and disillusionment."

American companies are not alone in confronting these hazards. Last week, BASF, the German chemicals group, concluded the largest deal with a Korean conglomerate since the crisis struck, agreeing to pay \$600m for a division of the Daesang group. Core Pacific of Taiwan has snapped up part of Yamachi's operations and has signalled its interest in Korean industrial assets. Prince Al-Walid bin Talal, the Saudi investor, has bought stakes in Korean and Malaysian automobile manufacturers and a Singaporean property group.

But US companies might bear the brunt of any reaction to foreign capital. To the extent the IMF is identified with the US, protests against the fund's policies tend to take an anti-US flavour.

The result, say US executives, is a premium on preparation. "It is absolutely crucial that we are not seen to be stampeding in, exploiting their problems," says one senior banker. "If we tread carefully, we will make the biggest strides."

Limited activity below the crisis



Source: CS First Boston

OBSERVER

Folz alarm for Calvet

The smooth acceleration of French carmaker Peugeot-Citroën with Jean-Martin Folz at the wheel is raising a dust cloud over the reputation of Jacques Calvet, his illustrious and long-serving predecessor.

Folz yesterday added another piece to the jigsaw with a distinctly Anglo-Saxon style target for return on capital employed – 12.5 per cent by 2001. He produced a chart showing return skidding from 21.7 per cent in 1990 to just 2.4 per cent in 1997.

The company created a stir last month by revealing that it expected a 1997 loss of \$408m, not helped by a provision relating to the abandonment of an ill-advised currency hedging exercise.

Calvet told the daily newspaper *Liberation* this did not correspond to his management of the group until September 30, 1997, but to the wishes of his successor. The accounts were *dévoilés* rather than *dévoilés* – a hard-to-translate French pun, implying that they were *wayward*.

Folz brushed this objection aside as more a word game than an analysis of the accounts. Will the loquacious Calvet now hold his tongue?

Karen Demichian's populist style doesn't betray the fact that he was

once a communist party boss. On a whirlwind tour of the Armenian backwoods drumming up votes for Monday's presidential election, he stops in small villages just long enough to shake a few hands, crack a few jokes and step in the blood of a lamb freshly slaughtered in his honour.

The 65-year-old Demichian ruled Armenia as first secretary of the communist party from 1974-88 when the then Soviet republic enjoyed an era of stability and relative prosperity. Now that times are hard, there's a temptation to recall the days when shops were full and salaries – *sousage* – cost a few kopecks.

Unofficial polls show the former communist apparition running close behind his much younger opponent, the incumbent Robert Kocharyan. Kocharyan has an uncanny likeness to actor Robert De Niro, but there's not much glitz or glamour about his campaign – he favours long, careful speeches in his unflashy Nagorno-Karabakh accent, all about how well he has done with privatisation and economic reform.

This pedestrian style is poor competition for the charismatic Demichian, who – apart from begging the nostalgic vote – is still pulling the old party trick of promising much without letting anyone in on the secret of how he plans to deliver.

Shop soiled

There used to be lots of little shops on the prairie before huge Wal-Marts and other discount stores put them

out of business.

Now Wal-Mart – founded by Sam Walton, who always seemed to be wearing a baseball cap and liked to drive around in an old pickup truck – is trying out something new. The latest wheeze involves smaller convenience stores, on the grounds that people might like to shop in the neighbourhood.

As Walton himself once said, on the way to becoming a multi-billionaire, the bigger the company gets, the smaller it has to act.

The opening of the new, compact Wal-Marts is sure to be better organised than the debut of Sam Walton's second store in Harrison, Arkansas, way back in 1964. Apparently the watermelons piled in front exploded in the July sun, the donkeys hired to give children's rides did what donkeys have to do, and the resulting mess was tidied through the shop.

Some neck

It's time for Ned Kelly – Australia's infamous bushranger who became a folk hero for robbing lots of banks with a tin can on his head, to be put back together – at least so his 93-year-old niece is claiming.

Kelly's skull was stolen in the 1970s from a display at the old Melbourne Jail, where he was hanged in 1880. A priest acting for the niece says the current custodian of the skull might give it back on a promise to bury it with the other remains, which were interred in 1925.

The niece yesterday called for the

whole of Ned to get "a Christian burial", but it appears that being reinterred to the old coffin is still a matter for discretion even 118 years after his death – the niece is carefully keeping her name out of the papers.

Graphic account

Selling Europe has never been the Eurocrats' strong point, but yesterday Brussels seemed to be getting its act together as it told the world that 11 countries were fit to join the single currency.

French monetary affairs commissioner Yves-Thibault de Stiguer, who's a bit of a techno-freak, used animated colour graphics to show falling inflation and public deficits.

Yesterday was the 40th anniversary of the signing of the treaty of Rome, which founded the European Union. Observer doesn't recall how well Euro-PR was handled then, but there have been some ragged displays in the intervening years. Yesterday's Emu fanfare suggests that the old dog might be learning some new tricks.

In conclusion

Even former Fed chairman Paul Volcker seems to be having trouble with European monetary union. Speaking in London on Tuesday night, he said he would give a balanced view on the planned single currency, but promised that, in due course, "I will come to some conclusion."

Financial Times

100 years ago

Spanish Threat To U.S. Navy New York, 25th March. An officer on board an American torpedo boat at Key West Harbour, when interviewed regarding Spain's torpedo flotilla, made the following statement: "If the United States Government allows the flotilla to reach Porto Rico, it will be a big mistake. The flotilla will be a greater menace to our fleet than the entire Spanish navy, for Porto Rico is nearer Key West than Cuba. There are only two torpedo boats in our navy which have any chance of escaping the flotilla. As a torpedo expert, I say that if every ship in the United States Navy were brought here there would be none too many when the strength of the flotilla is considered."

50 years ago

Africa Ports Congestion Mombasa, Kenya, March 24. Sir William Currie, chairman of the Peninsular and Oriental and British India Steam Navigation Companies, declared here today that he was concerned at delays at Mombasa and other East African ports, and that unless the African ports were "regular" sailing programmes will be impossible to maintain. "Ships have been delayed here almost three weeks, and shipping officials fear it may be necessary for certain ships to bypass this port."

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FINANCIAL TIMES COMPANIES & MARKETS

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THURSDAY MARCH 26 1998

Week 13

INSIDE

Deutsche Post may take DHL stake
Deutsche Post, the sprawling, state-owned German postal service, hopes to take a 22.5 per cent stake in DHL International, the express courier service that serves locations outside the US. Deutsche Post's increasingly commercial outlook has come about partly because of the liberalisation of European postal markets and preparations for its stock market listing in 2000. It is also reacting to the planned European single currency, which has accelerated the evolution of continent-wide businesses. Page 15

Canada set for telecoms shake-up
Canada's telecommunications industry is in upheaval after Telus, the Alberta-based local telephone company, confirmed it was in talks to form a "business combination" with AT&T Canada Long Distance Services. Such a combination could herald a wave of consolidation in the sector, which comprises 11 local telephone service providers and several long-distance competitors. The fragmented industry cannot match economies of scale in other countries. Page 20

GEC eyes spoils of blocked merger
The blocking of the merger of US defence groups Lockheed Martin and Northrop Grumman opens up huge new opportunities for General Electric Company, the UK electronics and defence group. With a euro-denominated credit facility for £6bn (\$8.5bn) and a cash pile of about £1bn (\$1.67bn), it could hope to buy some Lockheed and Northrop businesses, at least. It might even bid for Northrop. Page 21

Bufete going through a bad patch
Nothing seems to be going right for Bufete Industrial, Mexico's second largest construction company. The country is on its biggest infrastructure development drive in decades, but last year the three main government contracts - worth about \$3.75bn - slipped through Bufete's fingers. Its best client, oil monopoly Pemex, has had to retrench because of the drop in oil prices. And last week, Juan Alberto Zepeda Novelo, Bufete's pointman for oil development projects, was jailed on money laundering charges. Page 18

Oil rises on news of Opec meeting
World oil prices rose after the Organisation of Petroleum Exporting Countries confirmed it would meet next week to approve cuts in production. The emergency conference, to be held in Vienna on March 30, is expected to ratify the agreement reached in Riyadh at the weekend. Page 24

Yen advances on intervention talk
The yen rose against the dollar, helped by talk that the Bank of Japan might intervene to support its currency when the latest Japanese fiscal stimulus package appears today. The package is expected to be worth about ¥10,000bn (\$77bn), while some temporary tax cuts may be made permanent. Page 23

Zambian project loses Falconbridge
Zambia's hopes of reviving its copper industry, which is its biggest employer and accounts for about 90 per cent of its foreign currency earnings, suffered another blow when Falconbridge of Canada pulled out of the Konkola project. It is the third mining group to quit the \$800m venture, following Gencor of South Africa and Australia's WMC. Page 24

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EUROPEAN FILM INDUSTRY FRENCH BANK SEEKS TO CASH IN ON REVIVAL

SocGen to set up film finance unit

By Alice Rawsthorn

Société Générale, the French banking group, will today launch a London-based film financing division to take advantage of the revival of the European film industry. The launch follows the announcement yesterday that the UK government plans a wide-ranging overhaul of film policy to encourage foreign film groups to increase their investment in the UK and to forge closer links between the film production sector and institutional investors. The new SocGen unit will be run by Premila Hoon, headhunted from Guinness Mahon, the London-based merchant bank where she was head of media and entertainment. A prominent figure in UK film finance, Ms Hoon, 44, helped to finance 80 films, including *Howard's End*, *The Crying Game* and *Wild*, in 11 years with Guinness Mahon.

Guinness Mahon has stepped up its investment banking activities in the film sector, notably by advising Tony and Ridley Scott, the directors, on the acquisition of Shepperton, one of the UK's biggest production studios. The revival has been fuelled by a steep increase in cinema attendance following the opening of scores of new US-style multiplex cinemas. Several large European media and entertainment groups have either diversified into film or are expanding their existing interests. PolyGram, the Dutch music group, has invested more than \$1.2bn in the past seven years to establish a Los Angeles-based film subsidiary. At the same time, many Hollywood movie studios are strengthening their presence in Europe. Ms Hoon, as head of media for SocGen's project and sectoral finance group, said she will concentrate initially on developing its film finance interests. She declined to comment on how much SocGen plans to make available for film finance but said the financial resources available would be far greater than at Guinness Mahon. Michael Shyja and Thomas Gardiner, two members of Ms Hoon's team at Guinness Mahon, have also moved to SocGen. They will work closely with Bannan & Co, SocGen's Los Angeles-based banking subsidiary that specialises in the entertainment sector. Bannan recently advised PolyGram on its acquisition of a library of 1,000 films formerly owned by Credit Lyonnais. Funds venture, Page 18

Stephen Fry, left, starring in *Wild*, one of the films Premila Hoon helped to finance while head of entertainment at Guinness Mahon



Stephen Fry, left, starring in *Wild*, one of the films Premila Hoon helped to finance while head of entertainment at Guinness Mahon

S&P 500 records highest p/e ratio

By John Labeate in New York

Recent rises in US stocks have carried the price/earnings ratio on the S&P 500 index to its highest recorded peak, sparking fresh debate about whether the US market is trading at dangerously high levels. "What we're showing now is a price/earnings multiple of above 27 for trailing 12-month earnings with no adjustments for write-offs," said David Blitzer, chief economist at Standard & Poor's in New York. The ratio is calculated by dividing share prices, as measured by the S&P index, by earnings. In the past, notably in the early 1970s and in 1987, a high p/e ratio was followed by a heavy market fall. The issue of valuations has long caused deep division on Wall Street. But the US bull market has thrown the debate into sharper relief, now that the Dow Jones Industrial Average is nearing the 9,000 level and the S&P 500 is above 1,100. If earnings disappoint, such lofty levels could be met with rapid selling by investors. However, many analysts are unconcerned about current valuations. "You can't look at p/e multiples in a vacuum," said Alfred Goldman, chief market strategist at A.G. Edwards in St. Louis. "You have to look at them in relation to interest rates." With the long bond trading at a yield below 6 per cent, Mr Goldman and many others believe valuations can continue at current levels, and could go higher. Underpinning the market is the solid state of US economic fundamentals, with growth strong and inflation subdued. Analysts prefer to calculate valuations using forward, rather than trailing, earnings, although according to IBES, the information group, that ratio is also at its highest since the second world war. Compounding the valuation worry is the record low level of dividend yields, at 1.44 per cent, according to the latest S&P estimates. The bull market has also forced down dividend yields in the UK to their lowest levels since records began. However, instead of paying higher dividends, many US companies have opted for stock repurchase programmes. This is more tax-efficient for shareholders than dividend payments. Last, Page 12

Mitsubishi Electric chief quits after loss

By Michio Nakamoto in Tokyo

The president of Mitsubishi Electric (Meco), one of Japan's leading integrated electrical manufacturers, is resigning after the company recorded a loss and passed its second-half dividend. Meco's shares rose nearly 5 per cent to ¥390 (\$2.53) on the news. Takashi Kitaoka, president for six years, will step down in June after Meco, last month forecast a group net loss of ¥70bn for this year, compared with a profit of ¥8.5bn last year.

Mr Kitaoka will be replaced by Ichiro Taniguchi who has been in charge of the company's defence electronics and aerospace businesses. Mr Kitaoka had faced criticism for his failure to resign following revelations that Meco had been making illegal payments to corporate racketeers. Meco is expected to implement a wide-ranging restructuring, including the closure of several factories overseas. "Further restructuring is needed both overseas and in Japan, not only to cut back operations but to strengthen

those businesses where we have strength and to halt businesses that are no good," Mr Kitaoka said. "We will bring out all the rot at once, especially foreign factories, which have been making losses." As a result, the company is likely to post an extraordinary loss in the next fiscal year beginning in April. Substantial cumulative losses will remain, Mr Kitaoka said. Meco has already closed a semiconductor manufacturing plant in the US - believed to be the first such closure by a Japanese company - and a colour TV plant. The cost of over-

sees restructuring is ¥80bn. Meco is also considering pulling out of the household PC business in the UK and Japan to focus on the corporate market. Mr Kitaoka blamed the sharp downturn in the semiconductor and home electronics markets for the company's difficulties. Mitsubishi was slow to shift to advanced semiconductor technology and has been losing money in the division. It was also badly hit by the downturn in purchases of air conditioning units in Japan because of a mild summer. Executives indicated that

the company planned to shift its focus from D-Rams to systems-on-a-chip semiconductors that incorporate both memories and microprocessors. They said D-Ram technology would go towards building that business, in which Meco has an edge over competitors. Defence electronics and aerospace businesses will also be core operations, Mr Taniguchi indicated. But "we may be forced to withdraw from areas where Mitsubishi Electric has low market share or where the business is not solid", he said. Mitsubishi sector spotlight, Page 14

Singapore launches \$1bn convertible bond

By Vincent Boland

Singapore yesterday launched the biggest convertible bond out of Asia with a \$1bn issue exchangeable into shares of Singapore Telecom (SingTel), the city state's dominant telecommunications carrier. The five-year issue, which bankers said was "healthily oversubscribed", is a significant test of investor sentiment towards Asia's crisis-hit economies. It is also fresh evidence of the popularity of convertible bonds, one of the biggest growth areas in international capital markets this year. Singapore has, however, emerged relatively unscathed from the financial crisis afflicting most of its neighbours, and bankers said the fact that the bond was convertible into

shares of SingTel, one of the region's leading companies, drew substantial interest. John Hyman, executive director at Morgan Stanley Dean Witter, the US investment bank that lead-managed the deal, said it was the first significant test of sentiment towards Asia since the crisis erupted last autumn. "Singapore benefits because it is perceived as being the most stable place in the region, and Singapore Telecom is the blue chip in the market," he said, adding that the bond was more than twice as big as the next largest Asian issue. The bond was issued by Temasek Holdings, the Singapore government's holding company and investment arm. The total size of the issue will

rise to \$1.15bn if a "green shoe", or over-allotment, option is exercised, depending on the level of final demand for the bond. The bond will be convertible into SingTel shares at a price of \$63.38 each, a premium of just over 8 per cent on yesterday's closing price of \$58.12. Some 80 per cent of the Singapore bond was sold to international investors, with the rest going to Asian accounts. If the entire issue is converted into shares, it will see the state's stake in SingTel reduced by three percentage points. The company was privatised in late 1993 but the state remains its controlling shareholder. The advantage of the convertible bond route for the authorities in Singapore is that

they have raised \$1bn in five-year money immediately while retaining the stake in SingTel until conversion of the bond can begin. As well as testing investor confidence, the issue also confirms the enormous growth of the convertible bond market this year. Bankers say last year's record issuance of \$57bn will be topped in 1998, and the market globally is now worth

\$315bn, according to Deutsche Morgan Grenfell. Last month, SBC Warburg Dillon Read, the London-based investment bank, brought the world's biggest convertible issue to the market - a \$2.4bn bond on behalf of Bell Atlantic exchangeable into shares of Telecom Corporation of New Zealand. Markets, Page 34

Telefónica plans rights issue to fund acquisitions

By David White in Madrid

Telefónica, the privatised Spanish telecommunications group, announced plans last night to raise about Ptas600bn (\$3.9bn) in new capital in the largest operation of its kind ever launched by a Spanish company. The move, through a one-for-11 rights issue early next month, signals an aggressive phase of acquisition activity in Latin America, where the group has already invested some \$4bn. It will be the second big rights issue in a month, following an operation already under way by Banco Central Hispano to raise Ptas163.8bn, a record for the Spanish banking sector. Telefónica, which said it would set the price of the issue on April 1, made the announcement after a day of strong demand for its shares, which rose 4.6 per cent on the Madrid stock exchange to close at Ptas7,060. At yesterday's rate the issue would be worth Ptas602.9bn. A month-long subscription period is set to open on April 7. The company said it would apply to list the new shares in London, Paris, New York and Frankfurt as well as on Spanish stock markets. Morgan Stanley and the Spanish banks



Telefónica chairman Juan Villalonga: "Going on the attack"

abandoning of planned ties between the Spanish group and British Telecommunications. It includes a stake in WorldCom's European operations, a joint \$200m plan for a high-speed fibre optic network linking the US and Canada with central and south America. Juan Villalonga, Telefónica chairman, said last week that the group was "going on the attack" and announced plans to launch the group's Latin American division, Tisa, on the stock market. The group formalised a link-up yesterday with Portugal Telecom, setting up a 50-50 joint venture company aimed at entering new markets in North Africa, eastern Europe and Asia.

India calls,

the world answers.

Mahanagar Telephone Nigam Limited, representing around 20% of India's national telecom network, recently completed an issue of 35 million GDRs. HSBC Investment Banking was a joint global co-ordinator and assisted in raising over US\$400 million in India's second largest ever international equity offering. Simplifying complexity through resources, across the globe.

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COMPANIES & FINANCE: ASIA-PACIFIC

PERSONAL COMPUTERS TAIWANESE GROUP HELPED BY STRENGTH IN CORE BUSINESS

Acer shrugs off chip weakness to climb 22%

By Laura Tyson in Taipei

Acer, one of the world's biggest personal computer makers, performed solidly last year, helped by strength in its core business and despite troubles at its memory chip arm.

The Taiwanese group yesterday posted a 22 per cent rise in 1997 net profits to

T\$3.74bn (US\$1.15bn) on sales up 21 per cent at T\$39.74bn. The company plans to issue a dividend of T\$2 a share for 1997 and expects to launch a euro-convertible bond and global depositary receipts this year.

Acer has set a 1998 net profit target of T\$5.5bn, up 47 per cent from 1997. Its sales target for the year is

T\$88bn, an increase of 26 per cent from 1997. The convertible bond issue will raise as much as T\$8bn, with the funds supporting a planned capital increase and the operations of Acer Semiconductor Manufacturing, formerly known as Texas Instruments-Acer.

Acer took control of the unit earlier this month when

it bought out the 33.34 per cent stake held by joint-venture partner Texas Instruments, the US chipmaker. TI-Acer, a dynamic random access memory (D-Ram) chipmaker, had suffered from heavy losses because of oversupply in the memory chip sector.

Stan Shih, chairman of Acer, said the buyout would

enable Acer to shift away from D-Rams into more profitable areas such as foundry, or made-to-order, production. The company said it would this year issue 150m shares in global depositary receipts. The plan has to be approved at a shareholders' meeting on May 20.

The Acer board yesterday agreed to lift a cap on invest-

ments in China from US\$25m to US\$100m to expand an existing investment project in the Chinese province of Guangdong. The board has also decided to revise the company's charter to increase its capital from T\$28bn to T\$32bn in line with its planned expansion and issuance of convertible bonds.

Mitsubishi Electric looks for renewed performance spark

The resignation of the company's president highlights need for radical surgery, write Paul Abrahams and Michio Nakamoto

Takashi Kitaoka, president of Mitsubishi Electric, yesterday figuratively fell on his sword. After apologising for the company's poor performance while under his control, he resigned.

The scale of the group's underperformance during Mr Kitaoka's six-year reign is hard to understate. This year, Mitsubishi Electric will post a loss and pass its second-half dividend for the first time in more than 50 years. Since January last year, the shares have plunged more than 50 per cent. They have lost 70 per cent of their value since their peak in 1990.

Mr Kitaoka's replacement, Ichiro Taniguchi, was blunt about what needed to be done: "Today we announce the beginning of a new Mitsubishi Electric. The path we must travel is clear."

That path, according to Mr Taniguchi, includes expending strong operations and consolidating loss-making businesses. "On behalf of our shareholders, employees and customers, we must stay focused on the future and return Mitsubishi Electric to profitability as quickly as possible," he said.

In the short term, Mr Taniguchi's clarity of vision may reassure long-suffering investors. Yesterday, the shares bounced back 5 per cent. But in the long run, investors will need more than rhetoric to convince them that this diversified manufacturer of industrial, consumer and heavy equipment is capable of doing anything other than destroying value.

Their scepticism is given added weight by the fact that Mr Kitaoka, formerly viewed as a reformer, diagnosed most of Mitsubishi Electric's problems more than two years ago. But this cumbersome conglomerate refused to swallow the medicine he prescribed.

"Since I became president in 1992, I have tried to transform the culture of Mitsubishi Electric and prepare the company for the 21st century," Mr Kitaoka said yesterday. "Insiders say his efforts floundered because he failed to rally internal support. That was partly because the company had become lazy, counting on related groups such as Mitsubishi Estate and Mitsubishi Motors to buy its products without question."

The severity of the current crisis may help his successor, Mr Taniguchi, to create a sense of urgency. Almost everything that could go wrong for Mitsubishi Electric has gone wrong. Part of the problem has been the inclement economic environment. It has been badly hit by a domestic recession and the collapse in Asian demand overseas.

Its building-related businesses - elevators and escalators - have suffered from a decline in building starts at home and in the region. As for its industrial and automation equipment operations, they remain heavily geared to the domestic automotive industry, which last month suffered a sales drop of more than 20 per cent. The businesses are particularly exposed to Mitsubishi Motors, the weakest of the big five Japanese automotive manufacturers.

Similarly, the consumer electronics operation - which ranges from microwave ovens to vacuum cleaners - has endured lacklustre demand. Scott Foster, industrial electrical machinery analyst at ING Barings in Tokyo, estimates half the



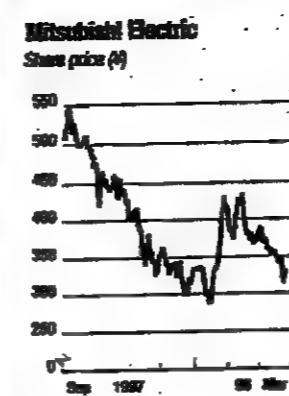
Ex-president Takashi Kitaoka: his medicine was refused

group's ¥70bn (\$537m) losses this year will be generated by consumer electronics. But the biggest problem has been semiconductors, where the damage has been mostly self-inflicted. "In 1994, we posted ¥50bn in net profits and I thought that things would be all right," said Mr Kitaoka. As a result, between 1994 and 1997, Mitsubishi Electric's semiconductor division invested ¥405bn in new capacity, mostly on new generation 64-megabyte D-Rams.

"But then the semiconductor market was badly hit and our development of

advanced 64-megabyte D-Rams backfired," he said. The legacy of that explosion in semiconductor investment is that Mitsubishi Electric's net debt-to-equity ratio mushroomed from just 40 per cent in March 1995 to 130 per cent this year. This year the group will be unable to cover interest charges with cash flow, according to Mr Foster.

So far, the company's response to the crisis has been feeble. Company executives have been reduced to praying for hot weather to stimulate additional demand



for air-conditioners. The company has already shut down colour television assembly facilities in the US and Malaysia, as well as an obsolete 4-megabyte D-Ram facility in Malaysia. But nearly all the cuts have been overseas. As Mr Kitaoka admitted, domestic restructuring has yet to begin.

Some action is in the pipeline. The semiconductor division announced yesterday it was cutting capital expenditure from its peak of ¥23bn in 1996 to just ¥5bn this year. That should also help reduce the group's huge depreciation charges.

But much more radical surgery is required. Mr Taniguchi will need to abandon the group's traditional, employment-oriented management style, while demonstrating a commitment to shareholder value so far lacking. To do so will require a revolution in Mitsubishi Electric's culture. It will be no easy task.

NEWS DIGEST

KOREA

Kia Motors says Ford is against Hyundai bid

Kia Motors yesterday claimed its single largest shareholder, Ford Motor, of the US, was opposed to a proposed takeover bid of the bankrupt South Korean carmaker by Hyundai Motor.

Kia made the comments after holding discussions with Paul Drenkow, head of Ford's Asia-Pacific operations, on future co-operation. Ford holds a combined 17 per cent in Kia along with its Japanese partner, Mazda. Ford has been negotiating with Samsung Motor on a strategic partnership, including a possible joint bid for Kia, which went bankrupt last year.

Kia, Korea's third largest carmaker, has opposed any takeover bids by either Hyundai or Samsung and Ford. It is awaiting a court decision on receivership, which would allow it to renegotiate its debts instead of liquidating its assets.

Kia is hoping to survive through a debt-for-equity swap with its biggest creditor, the state-run Korea Development Bank, while gaining new business by providing cars on an original equipment manufacturing basis to Ford.

Meanwhile, Hyundai Motor yesterday established an executive task force to plan a Kia takeover. Hyundai said its absorption of Kia would make one of the world's top 10 car companies, with an annual production capacity of 2.5m vehicles. John Burton, Seoul

HONG KONG TELECOMS

ABC sale hits SmartTone shares

Shares in SmartTone, the Hong Kong mobile phone operator, fell more than 6 per cent yesterday after one of its shareholders sold down a 12 per cent stake.

ABC Communications (Holdings), a Hong Kong paging and internet company, raised some HK\$1.17bn (US\$151m) from a private placement of 55.82m shares in SmartTone. The shares were sold at HK\$20.80, a 3.38 per cent discount to the latest 10-day average closing share price of HK\$21.52 before the deal was executed on Tuesday night. SmartTone's share price slid from HK\$22.80 to HK\$21.40 yesterday.

ABC Communications, which retains a 0.5 per cent holding, reaped a profit of HK\$75m from the placement. The placement was carried out by Goldman Sachs (Asia). Louise Lucas, Hong Kong

AUSTRALIAN ENERGY

Counter-bid hopes lift Allgas

Shares in Allgas Energy, an Australian natural gas distributor and equipment supplier, surged yesterday on speculation that Texas Utilities, the US energy company, would counter an AS204m (US\$137m) takeover offer by Boral, the energy and construction materials group.

Boral, which has an 11.8 per cent stake in Allgas, said yesterday it would offer AS18.75 for every Allgas ordinary share, representing a premium of AS1.50, or 8.7 per cent, over the existing bid by Texas Utilities' local arm. Allgas shares jumped AS1.01, or 5.6 per cent, to AS19.01 on speculation that Texas would lift its bid. Gwen Robinson, Sydney

Strong sales drive 33% rise at Sino Land Henderson Land loses ground in Hong Kong

By Louise Lucas in Hong Kong

Sino Land, the Hong Kong property developer, yesterday reported a 33 per cent rise in net profits at the interim stage, from HK\$764.69m in the six months to December 1997 to HK\$1.01bn (US\$130m) for the same period last year.

Results, which were ahead of expectations, were boosted by strong sales. At HK\$3.18bn, these were 98 per cent ahead of sales for the whole of the previous year.

However, the group also made provisions of HK\$400m against falls in the value of investments. Sales are set to remain robust as the group disposes of developments rather than retains them for rental. High interest rates and a credit squeeze among lenders in the territory have forced companies such as Sino Land to focus on cash flow.

Concerns that Sino Land, one of the more aggressive developers, could be vulnerable to the downturn in the

property sector arose in January. The company's share price fell 45 per cent to HK\$1.91 in one day after it moved to quash rumours that it had missed a loan payment.

However, the share price has bounced back and yesterday closed 4.5 per cent higher at HK\$4.026. Property stocks performed strongly yesterday after Tuesday's government land auction, at which two plots fetched higher than expected prices. The buyer of the biggest plot

offered this week was Nan Fung Development, a private property company which disclosed earlier this month that it had built up a 10 per cent stake in Sino Land.

Sino Land said yesterday it had seen a revival of buying interest from end-users in the first two months of the year. However, the Mayfair, a prestigious block of 60 flats, is being sold off at about two-thirds of the price that might have been achieved at the peak of the market last year.

Robert Ng, chairman, said there were signs that prices had bottomed out and stability had returned. "The flexible land sale programmes and the new tax incentive granted to mortgage borrowers will create a positive market environment conducive to sales of residential units," he said.

Earnings per share at the halfway stage rose 20 per cent, from 28 cents to 33.5 cents, but the dividend is being maintained at 10 cents.

Henderson Land loses ground in Hong Kong

By Louise Lucas

Depressed sentiment in the Hong Kong property sector took its toll on one of the territory's biggest property developers, as Henderson Land Development saw its interim profits tumble.

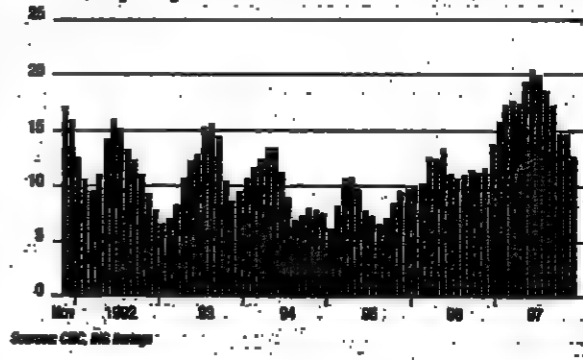
Net earnings fell 28 per cent, from HK\$5.32bn (US\$657m) in the six months to December 31 1997 to HK\$3.94bn for the same period last year. Henderson, in line with other developers, has been discounting prices for its new flats.

Although no new big developments were completed during the period, a large tranche of units was sold, which brought stock down to "an extremely low level". The group replenished its land bank, buying additional sites with attributable floor area of 1.06m sq ft during the interim period.

As it is one of the more conservatively geared developers, analysts are less concerned by the impact of the current tight credit environment on Henderson - particularly in recent weeks as interest rates have begun to ease.

Hong Kong property transactions

Number of agreements for sales and purchases (000) 3-month moving average



The group remained cautiously upbeat, saying that if coming development sales were satisfactory there would be "large amounts of cash inflow and abundant capital".

Henderson Investment, an associate company, saw interim net profits slide 16 per cent, from HK\$98.21m to HK\$73.42m.

Earnings per share fell from 32 cents to 26 cents, but the dividend is to be maintained at 13 cents.

The company built up its portfolio of holdings in "red chips", or mainland-backed companies, which have seen

their share prices plunge from their highs around the time of Hong Kong's handover to Chinese sovereignty. Henderson said the market value was above the book value at December 31.

Henderson China, the separately listed unit which holds the group's mainland activities, saw its net earnings almost halved, from HK\$163.96m to HK\$89.57m.

Earnings per share more than halved, from 46 cents to 20 cents, but the dividend is being maintained at 12 cents.

The decline in profits was attributed to a sluggish property market.

PSA PEUGEOT CITROËN

PSA PEUGEOT CITROËN 1997 FINANCIAL RESULTS • OBJECTIVES AND PRIORITIES

On March 24, the Supervisory Board reviewed the financial statements of PSA Peugeot Citroën, as closed by the Managing Board. The statements are in line with the estimated financial results presented and analyzed in the press release published on February 12.

1997 FINANCIAL RESULTS

Despite a collapse in the French market, PSA Peugeot Citroën experienced a year of growth in 1997, with registrations of Group cars and light commercial vehicles gaining 2.1% in Europe and sales of vehicles and CKD units surging 26.8% in the rest of the world. In all, Peugeot and Citroën sales totalled 2,106,400 vehicles and CKD units, a 5% gain on 1996.

Financial results for 1997 take into account a number of exceptional events occurring during the year, as well as changes in valuation methods made to comply with changes in accounting standards and shifts in the Group's marketing and manufacturing techniques. In addition, presentation of the financial statements was improved to make the Group's business and financial results easier to understand.

Taken together, the exceptional events and changes in valuation methods resulted in the recording in 1997 of an additional pre-tax expense of FF 4,383 million and of an additional FF 630 million provision for deferred taxes. Both of these items are non-recurring and will have no impact on future results.

Consolidated net sales amounted to FF 186,785 million. On a comparable basis - i.e. excluding changes in methods - net sales gained 8.3% over the year to FF 187,107 million. Operating margin amounted to FF 683 million. Excluding exceptional items and changes in methods, it totalled FF 2,395 million, a clear improvement over the FF 1,675 million reported in 1996.

The loss before income taxes amounted to FF 3,504 million. Excluding exceptional items and changes in valuation methods, this item amounted to income of FF 881 million. The net loss before minority interest came to FF 2,497 million, while the net loss for the year totalled FF 2,768 million.

Working capital provided from operations amounted to FF 10,891 million, or 5.8% of sales. Gross capital expenditure was stable at FF 10,246 million.

At FF 1,866 million, net indebtedness of the manufacturing and marketing companies was reduced by FF 7,009 million during the year, primarily due to the surplus of working capital provided from operations over capital expenditure for the year and the sharp reduction in working capital requirements. After fully consolidating the finance companies, the Group had consolidated net cash position of FF 4,812 million.

Consolidated shareholders' equity amounted to FF 32,999 million at year-end, or FF 1,658 per share. Based on the non-recurring nature of the exceptional events weighing on 1997 earnings and the outlook for 1998, the Managing Board will ask shareholders at the Annual Meeting on June 3 to approve the payment of a dividend unchanged from last year at FF 3.00 per share (FF 4.50 including tax credit). If approved, the dividend will be paid as of June 10, 1998.

OBJECTIVES AND PRIORITIES

The Supervisory Board was also informed of the Managing Board's objectives and priorities, which reflect a commitment to significantly enhancing innovation capacity, revitalizing sales momentum and rapidly improving margins.

Return on capital employed has averaged 4.3% over the past four years. The Managing Board has set a threshold for 2001 of 12.5%, the level required to secure sustainable development. To achieve this goal, the first objective is to continue carefully managing capital expenditure and to improve dealer inventory management. At comparable business volumes, these measures are expected to reduce capital employed by FF 10 billion, particularly in the Automobile Division. At the same time, operating margin on the automobile business is targeted to exceed 4.5% in 2001. It will end 1998 at more than 1.5%.

The Managing Board has already undertaken its first action plan. The new organization implemented in January expresses a strategic focus on two broadline markets with strong personalities, offering a closer fit between their line-ups and emphasizing product innovation to drive market share gains. In Europe, the two critical markets will be France and Germany.

Internationally, the objective remains to generate 25% of sales from outside western Europe, with a sharper focus on the Mercosur countries in Latin America, eastern and central Europe and selected countries in Asia. Major steps towards achieving this goal include the development of closer ties with Brazil, the start-up of construction on a plant in Brazil, the strengthening of dealer networks in central and eastern Europe and the continued development of operations in China and Malaysia.

The new platform strategy is aimed at accelerating the reduction in vehicle cost prices, capital expenditure and the time-to-market cycle. The number of PSA Peugeot Citroën platforms will be reduced from seven to three, while production facilities will gradually be organized according to the new concept, with each of the six main plants dedicated to a single platform.

The merger of Edin and Bertrand Falret confirms the Group's strategy of developing a strong presence in the automotive equipment business. It will create a world-class group with leadership in each of its businesses and the critical mass needed to ensure its development. The first effects of these measures will lift consolidated operating margin to at least FF 5 billion in 1998.

SUMMARY CONSOLIDATED FINANCIAL RESULTS

	1997 approved	1997 comparable	1996 reported
Net sales	186,785	187,107	177,098
Operating margin	683	2,395	1,675
Net income	5,584	881	881
Minority interest	(2,897)	n.c.	948
Net income	(2,768)	n.c.	734

CASH FLOWS AND FINANCIAL POSITION

	1997 approved	1996 reported
Operating cash flows	10,891	11,360
Investing cash flows	(10,246)	(10,246)
Financing cash flows	9,337	9,894
Net change in cash	5,584	9,894
Net cash position	(4,812)	(4,812)

PSA PEUGEOT CITROËN	
Number of vehicles	2,106,400
Manufactured sales	2,106,400
Worldwide production	2,378,600
Work force	149,200

INTERNET: <http://www.psa-peugeot-citroen.com>

JPM 10/50

COMPANIES & FINANCE: EUROPE

PROPERTY INSURANCE GROUP BRANCHES OUT

INA seeks partner for new venture

By James Birtz in Rome

INA, Italy's second largest insurance group, is looking for an international partner in the field of property to help develop a residential and commercial property company it set up this week.

In a bid to develop what would become one of Europe's largest property companies by book value, INA is searching for an international group willing to take a stake of up to 10 per cent in the newly expanded Unione Immobiliare SpA. It holds property with a book value of about £5,000bn (\$2.78bn).

Lino Benassi, INA managing director, said yesterday that he planned to launch Unione Immobiliare on the Milan stock exchange before the end of this year.

About 80 per cent of the group's shares are to be held by existing INA shareholders, including leading banks and credit institutions such as San Paolo, IMI and Cariplo.

However, the INA group's holding company, INA SpA, is planning to sell its stake of up to 20 per cent over the next 18 months.

In general terms, it is looking to sell part of its stake through a public share offer. The remaining portion will be sold through a private placement to a strategic partner willing to help develop the new company.

Mr Benassi said the partner he sought could come from North America, Europe or south-east Asia and would bring much-needed expertise in property management to Unione Immobiliare.

"We have a company here that has huge assets and capital and no debt," he said. "But we badly need to get people who know about real estate management and can develop the business."

Mr Benassi's comments followed a decision this week to transfer most of INA's property holdings to Unione Immobiliare.

The new company's property assets are equally divided between the commercial and retail sectors. About two-thirds of the property is in Rome; the remaining one-third is in Milan.

The company's book comprises about 10,000 residential apartments.

A new chief executive for the group is to be appointed by June.

Mr Benassi admitted that the Italian property market had been in the doldrums in recent years, not least because of laws fixing rents that are only gradually being relaxed. He said he was looking for a partner that could pump liquidity into the group and fears that many of the existing shareholders are from the financial services sector and lack a fundamental commitment to property.

Argentaria plans internal merger

By Tom Burns in Madrid

Argentaria, the fourth-ranked Spanish banking group, which was recently privatised, said yesterday it planned to merge its main units to realise latent capital gains, reduce operating costs and lift its competitive edge.

The bank also plans to reduce the nominal value of its shares to track rival banks which have broadened their equity holder base through stock splits.

Argentaria's shares rose by Ptas90 yesterday to close at Ptas13,300 - a rise of 8.4 per cent on a day when the overall market rose 1.9 per cent.

Francisco González, Argentaria chairman, has pledged to raise the group's return on equity (ROE) from a low 10.5 per cent to 15 per cent by the end of 1998. In his bid to compete with more profitable domestic banks, he is seeking to lower Argentaria's ratio of operating costs to operating income from 56 per cent to 50 per cent by 2000.

The move involves the absorption by Corporación Bancaria de España, the Argentaria group's holding company, of Banco Exterior, Caja Postal and Banco Hipotecario. The three units,

which form the group's core retail banking business and operate 1,700 branches among them, will form just one bank named Argentaria, offering common products to a single client base.

The bank's retail muscle has been further strengthened by an agreement with Spain's PTT that allows Argentaria to provide banking services through 1,700 post offices for an initial 10-year period. A regional subsidiary, Banco de Alicante, based in the south-east, could be incorporated when Argentaria completes a takeover bid for the 6 per cent of the unit it does not own.

The merger will not include three specialised divisions: Banco Directo, which operates a telephone banking network; the merchant banking arm, Banco de Negocios; and Banco de Crédito Local, financing municipal corporations.

Analysts believe the merger will allow Argentaria to declare capital gains of Ptas100bn (\$6.44m) through revaluation of assets at Caja Postal, a former Post Office savings bank. These gains were not declared when the unit was one of six state-controlled financial institutions brought together under the Argentaria umbrella in 1991.

SocGen, Russell in funds venture

By Jane Martinson, Investment Correspondent

Société Générale Asset Management, which is owned by the French bank, has joined Frank Russell, the US consulting firm, to offer multi-manager funds in continental Europe.

The joint venture is designed to take advantage of the shift from traditional banking relationships to dedicated asset management in Europe, where the business is dominated by large financial services groups. Multi-manager funds, rare outside the US, offer investors the opportunity to put money into a range of asset classes using different managers.

Len Brennan, head of Russell's international operations, said the new service is "right" for the new service as retail investors and institutional investors are looking for alternatives to traditional managers.

The consultancy currently manages \$38bn, mostly in the US, with 50 different managers. Its initial list of continental European clients will, perhaps surprisingly, not include SocGen.

Mr Brennan said the managers were chosen under strict guidelines and the joint venture did not give SocGen, which manages \$125bn for external clients, any advantages.

"The whole way multi-manager works is that Frank Russell has total independence in the selection of money managers," he said. Russell has increased its fund management business on the back of joint ventures with large financial organisations in Canada, Australia and South Africa.

The group is keen to launch a similar tie-up in the UK. Russell started its first multi-manager fund 18 years ago. The aim of the service is to reduce risk and volatility, partly by diversifying through a range of styles.

Mr Brennan said the group's first fund - which is now worth \$7bn, has outperaced the Russell 1000, its benchmark index, by 200 basis points a year over the past 10 years.

The new venture - to be called SG/Russell Asset Management - will operate within a Dublin-based offshore fund.

German delivery for DHL

Change is forcing Deutsche Post to act, writes Ralph Atkins

Before his death in an air crash three years ago, the entrepreneur Larry Hillblom lived a colourful lifestyle from his south Pacific island home.

He probably never dreamt his shares in the DHL express courier service he co-founded three decades ago in San Francisco would end up with Deutsche Post, the sprawling, state-owned German postal service.

But yesterday Deutsche Post confirmed that it planned - subject to approval by European competition authorities - to take over Mr Hillblom's 23.5 per cent stake (and an option to increase its holding to 25 per cent) in DHL International, which serves locations outside the US.

The strategic alliance would bring access to DHL's network, which connects 227 countries, and experience of customer-oriented air parcel services - a market estimated to be growing at more than 15 per cent a year.

DHL would gain a partner which provides a large chunk of Europe's road and rail distribution links. "The trend," says Klaus Zumwinkel, Deutsche Post chief executive, "is quite clearly

towards European logistics solutions from one source."

For Deutsche Post, there have been two main factors forcing an increasingly commercial outlook. First has been the liberalisation of European postal markets and preparations for its stock market listing in 2000. Under Germany's new post law, it has been given some protection. Until the end of 2002, Deutsche Post will have a monopoly in the handling of standard letters up to 200g and bulk, or "junk" mail, up to 50g.

But already Deutsche Post is facing stiff competition in the parcels business - and its rivals are putting pressure on Brussels to squash any attempt by the state-owned concern to use its domestic letter monopoly as a means of subsidising commercial parcel services.

Yesterday, the European Express Organisation, representing other express courier services, called again for firm implementation of competition rules.

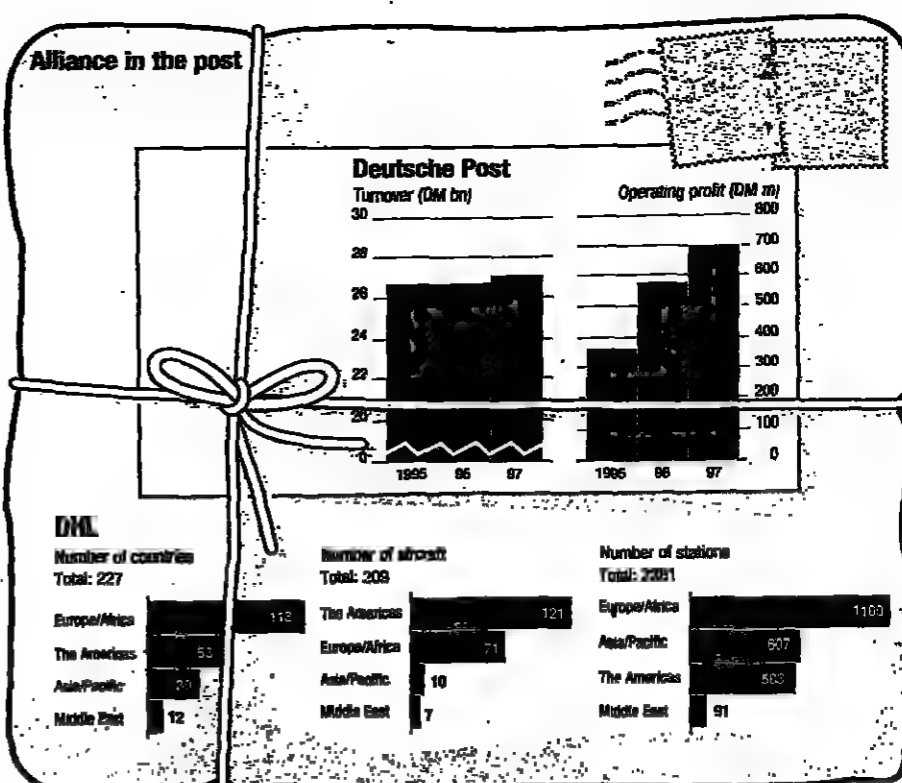
Mr Zumwinkel argues, however, that if costs associated with Deutsche Post's inherited pension liabilities and public service obligations are stripped out, "all

areas of Deutsche Post are profitable". The DHL deal was "ideally timed", coming as a previous co-operation deal expired with TNT, the Australian parcel service taken over by the Dutch postal service.

Moreover, Deutsche Post would argue the DHL deal was made necessary by the second factor forcing change: the expected impact of the planned euro currency in accelerating the evolution of continent-wide businesses. Some 80 per cent of Deutsche Post's turnover comes from commercial customers. DHL's experience in cross-border deliveries was a natural addition to Deutsche Post's extensive domestic infrastructure.

From DHL's perspective, a two-tiered European market is being created similar "to how the US market has emerged over the past 10 years," says Patrick Lupo, DHL executive chairman. Customers want either the overnight service, as specialised by DHL or they want an extensive road and rail-based service that takes a little longer.

DHL expects to co-brand its services which will be



available through Deutsche Post's 15,000 branches. DHL will also offer Deutsche Post services to its clients - such as late night pick-ups.

A more immediate gain for DHL will be the undisclosed proceeds from the sale of Mr Hillblom's stake, which has been bought in temporarily

power. Its other main shareholders are Lufthansa, the German airline, Japan Airlines, Nippon Iwai, the Japanese trading house and private shareholders. Minority shareholders will have rights protected when big decisions are taken. But DHL now has a distinctly German feel.

CITICORP

GLOBAL REAL ESTATE FINANCE

UNITED KINGDOM	UNITED KINGDOM	FRANCE
£142,000,000 Asset-Backed Floating Rate Notes Parcs Limited 24 Commercial Mortgages/ Office and Retail United Kingdom Citibank International PLC - Advisor and Lead Manager	£128,100,000 Asset-Backed Floating Rate Notes Mooncrest PLC Single Office Building London Citibank International PLC - Advisor and Lead Manager	FRF 1,879,000,000 Asset-Backed Floating Rate Notes Rock Funding PLC Multifamily Properties France Citibank International PLC - Advisor and Sole Manager
FRANCE		UNITED STATES
FRF 2,020,000,000 Asset-backed Floating Rate Notes La Defense PLC Five Office Buildings Paris, France. Citibank International PLC - Advisor and Sole Manager		US\$658,500,000 158 Fixed Rate Mortgages Commercial Mortgage Pass Through Certificates Mortgage Capital Funding, Inc. 1997-MCI Citibank, N.A. Co-Lead Manager
UNITED STATES	UNITED STATES	UNITED STATES
US\$250,000,000 5-year Floating Rate Term Loan BRE/SWISS, LLC (An Affiliate of Blackstone Real Estate Advisors) A Portfolio of Four Swissôtels New York, Chicago, Atlanta, Boston Citicorp Securities, Inc. - Sole Arranger	US\$100,000,000 18-Month Floating Rate Term Loan Davidson Hotel Partners, L.P. A Portfolio of 14 Hotels in Eight States Citicorp Securities, Inc. - Co-Arranger	US\$50,200,000 18.5-year Fixed Rate Loan TA Warner Associates, L.P. 427,000 sq. ft. Office Building Complex Woodland Hills, CA Citicorp Securities, Inc. - Sole Arranger

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COMPANIES & FINANCE: EUROPE

NEWS DIGEST

BANKING

Bank Austria takes Sch3bn charge for restructuring

Bank Austria, Austria's biggest banking group, is taking a Sch3bn (\$233m) charge to cover restructuring costs following last year's acquisition of Creditanstalt, the country's second biggest bank. Despite the charge, the group's 1997 net income rose by about 25 per cent to Sch5.5bn.

The group's net profits, prior to the special charge, roughly doubled in 1997 to Sch8.5bn. In January the group had forecast net profits of Sch7.5bn for 1997. Bank Austria's preference shares have more than doubled over the last year following the takeover of Creditanstalt.

Group operating income rose by 4 per cent, to Sch4.2bn, and operating costs were roughly unchanged at Sch2.8bn. The group is expected to increase its Sch12 a share dividend by more than 15 per cent. William Hall, Zurich

PHARMACEUTICALS

Rhône-Poulenc share swap

Rhône-Poulenc, the French pharmaceuticals group, is to simplify its balance sheet by offering holders of "participating shares" an opportunity to exchange them for new ordinary A shares. The company is offering 11 ordinary shares for each participating share issued between 1983 and 1988. If all 993,883 participating shares were tendered, it would result in the creation of about 10.9m new ordinary shares to add to the 360m currently outstanding. At Tuesday night's closing price of FF277.50, these new shares would be worth about FF3bn (\$489m).

Patrick Langlois, chief financial officer, said the move would reduce financing costs and was expected to have a positive impact on net income. In parallel, the company has decided to propose the conversion of the 926,620 preferred B shares outstanding into ordinary A shares at an exchange rate of one to one. David Owen, Paris

ENGINEERING

Rheinmetall advances fourfold

Rheinmetall, the fast-growing German engineering group, quadrupled net earnings last year from DM45.4m to about DM180m (\$98m), reflecting acquisitions, rationalisation and a policy of focusing on its core electronics, auto parts, machine building and defence equipment businesses. In a letter to shareholders it predicted higher profits this year.

Rheinmetall's operating profit jumped from DM91.7m in 1996 to a record of about DM300m last year, on sales increased from DM3.66bn to DM6.58bn. Incoming orders last year were also a record, rising 80.8 per cent to DM7.16bn. Peter Norman, Bonn

BROKING

LB Kiel buys Danish broker

Landesbank Schleswig-Holstein Girozentrale (LB Kiel) is to acquire the entire share capital in the Copenhagen brokerage house of Gudme Rasmussen, which is active throughout the Nordic area in mergers and acquisitions, public share offerings and capital markets business, the two companies said yesterday. Gudme Rasmussen, founded in 1828, was one of Denmark's few remaining independent brokerage houses. Hilary Barnes, Copenhagen

SOFTWARE GERMAN GROUP LAUNCHES STOCK PLAN TO REWARD LOYAL EMPLOYEES

SAP warns of slowdown in growth

By Paul Taylor

Shares in SAP fell yesterday after the leading European software group repeated its warning that growth would slow sharply this year and outlined a "virtual stock" plan to help it retain skilled employees.

SAP's shares closed DM4 lower at DM791 in Frankfurt. The German software group - the leader in the fast growing market for enterprise resource planning software used by multina-

tionals to manage operations - repeated its forecast that sales would grow by between 30 per cent and 35 per cent this year.

The group, which announced provisional results for 1997 at the end of January, saw sales surge 62 per cent to DM6.02bn (\$3.29bn) last year and net profits grow by 63 per cent to DM924m.

Yesterday the company, ranked as one of the biggest software vendors in the world, said lower interest

and operating yield would cut its pre-tax margin by 1 per cent or 2 per cent this year, while the proposed employee share plan would weigh further on its results.

"As a global company, we see a strengthening of international competition for the best employees," Henning Kangermann, a management board member, said.

Mr Kangermann, who is expected to become co-chief executive when Dietmar Hopp, an SAP founder, steps down in May, held back from

repeating SAP's earlier forecast that pre-tax profits would increase at about the same rate as sales. He said that the employee incentive programme would affect earnings per share this year.

Under the terms of the proposed incentive plan, designed to avoid the dilution effects and legal delays associated with standard stock options, loyal employees will be rewarded with "virtual shares".

The plan would allow

about 8,000 of SAP's rapidly growing workforce, which totalled almost 13,000 at the end of 1997, to benefit from gains in SAP's share price. The shares have risen more than 30 per cent this year and nearly quadrupled over the past 18 months.

However, analysts said, yesterday that the plan, although initially limited to one year, added a new element of uncertainty to SAP, one of Germany's most consistent growth stocks on the blue-chip DAX index. "It is

not clear how much this programme will cost. There are a lot of unclear issues," said Johan Khusmann, an analyst with Bank Julius Baer.

SAP, which plans to list on the New York Stock Exchange on August 3 and is adopting US GAAP accounting rules, said yesterday that under the US rules its 1998 net income would be about five or six percentage points below the figure under Germany's HGB rules. Under US rules, 1997 net profits would have been 5.3 per cent lower.

VW sets its sights on new horizons

German vehicles group to target luxury car, truck and off-road markets

By Graham Bowley in Wolfsburg

Volkswagen of Germany yesterday confirmed ambitious plans to expand into new luxury car, truck and off-road vehicle markets. But Europe's biggest carmaker warned that sales this year had been hit by the slowdown in Asia and South America.

Ferdinand Piëch, chief executive, who revealed yesterday that VW this week bid for Rolls-Royce of the UK, said group earnings growth in the first three months of this year was "more favourable" than at the same stage last year.

"Our markets are booming," Mr Piëch said. "Our earnings will definitely be better than in 1997."

But he conceded sales were depressed by difficulties in Asian and South American markets as well as production problems with the launch of the new Golf model.

European vehicle unit sales grew 8.4 per cent in the first three months compared with last year. Worldwide sales in the period grew 2.2 per cent. Sales in Asia dropped 10 per cent while sales in South America plunged 35 per cent.

VW had earlier this month reported that net profit doubled last year to DM1.36bn

(\$743m) on the back of a 12 per cent increase in sales to DM113.2bn.

The group signalled it was pressing ahead with plans to build a new off-road sports utility vehicle in co-operation with Porsche, the German sports car maker.

Robert Büchelhof, board member, said: "We would like to penetrate this important segment. We are talking about co-operation with Porsche... we are making good progress on this."

Mr Piëch repeated VW's intention to enter the heavy truck market by 2010 at the latest. VW would do this by developing new models internally, through co-operation with another manufacturer or by buying a stake in another company, he said.

Mr Piëch said VW would press ahead with plans to enter the top-end luxury car market irrespective of whether the bid to acquire the Rolls-Royce and Bentley brands from Vickers of the UK was successful.

"Independent of the Rolls-Royce bid we might get an additional two-to-three top of the range models. If we are lucky they will be the two we have bid for."

"This wish for two luxury marques could be filled by acquiring the British brands or we create something home-grown, revive histori-



Ferdinand Piëch with VW's New Beetle, demand for which is 'overwhelming'. Picture: Reuters

cal brands that belong to us already or that do not belong to us."

Analysts said VW could revive brands such as Horch, an old German car name controlled by Audi, if the bid for Rolls-Royce failed.

Group orders in the first three months were 690,000 vehicles, 178,000 more than at the same stage last year.

Mr Piëch said VW production would be raised from 2,740 to 3,500 units daily in order to halve delivery delays of four to six months.

Speaking at the group's annual press conference, Mr Piëch warned that overcapacity and competition meant there would be a sharp consolidation in the world automobile industry in coming years.

VW, which will bring eight new passenger cars on to the market this year, including the New Beetle, wanted to be in a position to build 6m a year by the turn of the century.

"In the long run, only around 10 to 12 groups of

competitors will be left to compete with one another," he said.

Demand for the New Beetle, which will be launched in North America this month, was "overwhelming", Mr Piëch said.

But Jens Neumann, a board member, said no decision had been taken yet on whether to build a factory in either Mexico, the US or Canada to cope with the strong demand.

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Peugeot maintains pay-out despite loss

By David Owen in Paris

Shares of Peugeot-Citroën rose strongly yesterday after the French carmaker announced it was maintaining its dividend, in spite of reporting a substantial loss in 1997.

The shares surged FF97, or 10 per cent, in Paris to FF1,070, as the group also announced a number of ambitious targets, particularly for return on capital and for 1998 operating profits.

But Peugeot reported an annual net attributable 1997 loss of FF2.77bn (\$452m), against net income of FF774m in 1996.

This had been foreseen, however, by an announcement last month that the group expected a net loss of FF2.5bn after taking into account FF2.5bn of one-off items. These included a provision of FF1.44bn relating to the abandonment of an ill-advised currency hedging exercise.

Unlike 1996, when the net dividend was cut from FF5 to FF3 in the wake of a 57 per cent fall in annual profits, the managing board is this time proposing an unchanged payment of FF3.

Jean-Martin Folz, the recently installed president, set a 1998 target for the group's consolidated operating profit of at least FF5bn. This compares with operating profit of FF688m in 1997, down from FF1.68m.

Excluding exceptional items and changes in valuation methods, however, last year's operating profit was put at FF2.4bn.

Mr Folz, who has moved swiftly to put his stamp on the group after taking over from Jacques Calvet last autumn, also announced a 12.5 per cent target for return on capital employed, to be achieved by 2001.

This compares with an average of 4.3 per cent achieved between 1994 and 1997 and just 2.4 per cent last year.

The management board believes 12.5 per cent is the level required to secure "sustainable development".

Excluding exceptional items, but using the new presentation of the group's financial statements, the vehicles division made an operating loss of FF365m in 1997. Mr Folz acknowledged this was not the first time the unit had made an operating loss.

Non-vehicle operations contributed a profit of FF1.7bn and finance operations a profit of FF1.3bn.

In spite of the collapse of its domestic market, the group achieved a per cent increase in unit sales in 1997 to 2.1m. In all, 79 per cent of sales were made outside France and 16 per cent outside Europe.

Observer, Page 11

French bank rescues Natexis in FF7bn deal

By Andrew Jack in Paris

Banques Populaires, the French co-operative banking group, yesterday came to the rescue of Natexis, the Paris-based business bank, with a friendly takeover worth more than FF7bn (\$1.14bn).

The deal would protect Natexis from a hostile takeover and strengthen its ability to generate \$250m-\$300m from an issue of preference shares in the US by the summer.

Coupled with a planned rights issue this autumn representing up to 15 per cent of the capital, the operation would allow Natexis to raise about FF2.5bn in new capital to strengthen its balance sheet against its exposure to property lending and the Asian markets crisis.

Banques Populaires, which acquired a 23 per cent stake in Natexis last October with an option to climb to 30 per cent, launched a bid at FF440 a share, with FF822 for its convertible bonds and FF520 for subordinated shares.

It was advised by Goldman Sachs.

It stressed it wanted to acquire at least 61 per cent

control of Natexis but wanted to maintain a minority of the shares - of up to a third - on the Paris stock market to allow future rights issues.

The co-operative status of Banques Populaires protects it from takeover. It also blocks its ability to acquire full control of Natexis.

Banques Populaires would be able to expand its international and corporate business as a result of the deal, while Natexis would gain access to a retail network.

Natexis - formed from the merger of the Banque Française du Commerce Extérieur and Crédit National - yesterday unveiled provisions of FF550m related to its Asian exposure.

Emmanuel Rodocanachi, chairman, said: "We were starting to lack a bit of margin for manoeuvre. This operation will give us the ability to boost our market penetration in France and help our expansion in Asia and other emerging markets."

He added that "obviously I infinitely preferred a friendly takeover to a hostile one".

ALCATEL ALSTHOM

1997 Net income: FF 4.7 billion Further redeployment of the Group

Alcatel Alsthom's Board of Directors, chaired by CEO Serge Tchuruk, met on March 18, 1998, and approved the 1997 audited financial statements.

In 1997, Alcatel Alsthom posted net income of FF 4.7 billion, slightly above the estimate previously announced on January 29, 1998.

The improvement in profits is in line with the action plan put into place more than two years ago. In spite of continuing strong pricing pressures, the Group benefited from the growth in telecommunications, while operating from a better managed cost base.

As a sign of confidence in the Group's outlook, the Board of Directors will propose to the Annual Shareholders' Meeting on June 18, a dividend per share of FF 11.50, a 15% increase over the previous year, and representing a total dividend per share of FF 17.25, including tax credit.

1997 RESULTS

1997 net sales increased by 14% to FF 185.9 billion compared with FF 162.1 billion in 1996. On a comparable basis, sales increased by 8%. Orders increased by 11% in 1997 and, on a comparable basis, by 5%.

Research and development expenses were equivalent to those of 1996 at FF 16.6 billion and represented 8.9% of sales.

Income from operations, before financial results, rose to FF 8.0 billion or 4.3% of sales. The increase of FF 5.1 billion compared to the previous year resulted from the improved performance in all of the segments, with the most significant improvement coming from Telecom.

The Group found it prudent, in light of the deteriorating crisis in certain countries in Southeast Asia (Indonesia, Malaysia, Philippines, and Thailand), to register provisions for risks in the amount of FF 500 million which are included in income from operations. It should be noted that these four countries represented less than 5% of the Group's sales in 1997.

Income before taxes and equity affiliates amounted to FF 5.6 billion compared with FF 2.7 billion in 1996 and included the financial results, restructuring costs and amortization of goodwill. It also takes into account capital gains realized from the program of non-core asset disposals, of which the most significant resulted from the sale of Havas' shares.

Income tax amounted to FF 1.3 billion in 1997, against FF 0.7 billion in 1996 which included exceptional savings of FF 0.6 billion, resulting from recognizing tax consolidation in the year in which it occurred. Share in net income from equity affiliates, which now mainly includes Funamote and Shanghai Bell, amounted to FF 0.6 billion compared with FF 1.0 billion in 1996. Net income after minority interests reached FF 4.7 billion compared with FF 2.7 billion in 1996.

The Group's net financial debt went from FF 13.1 billion in 1996 to FF 11.9 billion in 1997, resulting in a ratio of net debt to shareholders' equity (gearing ratio) of 27% at the end of 1997, versus 33% at the end of 1996.

OUTLOOK

1997 represents a significant step in the Group's recovery. Beyond the actions taken to improve the efficiency of operations, Alcatel Alsthom has continued to refocus its business by launching two strategic operations, which should be completed during 1998:

• It is intended that GEC Alsthom, which has become an industrial success, established on a constructive pan-European cooperation, would be listed on the stock market during the first half of 1998.

• The alliance with Thomson CSF also contributed to the reshaping of Alcatel Alsthom. It will allow, in particular, for the creation of a worldwide business in communication satellites, managed by Alcatel. The common development of technologies, both civilian and military, should provide significant economies of scale and synergies for both groups.

A new operation is also being considered, which would consist of selling the major part of the Engineering and Systems activities, principally Cegelec, to GEC Alsthom, which will bring together two entities of the Group in businesses and markets that have more and more similarities. Alcatel Alsthom would achieve another important step towards the unification and the valorization of its interests in energy, transport and industrial activities.

In this clarified context, Alcatel Alsthom will pursue in 1998 the actions necessary to further improve its profitability.

These actions will be oriented toward productivity gains and growth and will benefit from the strong development of data traffic and mobile communications. Anticipating market changes, Alcatel has succeeded in developing a new generation of switches offering the bandwidth and functionalities capable of efficiently managing Internet traffic and associated protocols. Also in public switching, where the resumption of growth is expected, Alcatel has been able to combine the functionalities of fixed and mobile communications, in order to supply operators one serviceone terminal solutions.

Finally, benefiting from its success in transmission, which enabled it to become the world leader, Alcatel intends to develop this business which includes subscriber access, submarine networks, and satellites. This business should generate a significant contribution to 1998 earnings. It is, in particular, with developments in switching, transmission and access that Alcatel intends to pursue the remarkable breakthrough that it has achieved in the U.S. during the last two years.

Finally, after a period of profound change, and due to these new developments, the Group looks to the future with confidence. The growth in its earnings should continue in 1998, independently of the significant structural changes currently being undertaken.

"Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995: This press release contains forward-looking statements relating to the Group's expectations for an improvement in profitability. Such expectations assume that (i) the Group will benefit from growth in the telecommunications market, and (ii) the Group's sales volume will increase in several product markets. Actual results could differ materially from the above as a result of these or other factors.

growth

Peugeot
maintains
pay-out
despite la

bank
Natexis
7bn deal

Issued by Credit Suisse First Boston (Europe) Ltd, regulated by SFA.

WORLD CLASS PERFORMANCE IN 1997

PRODUCING RESULTS FOR OUR CLIENTS AND OUR SHAREHOLDERS.

- \$7.1 BILLION IN REVENUE
- \$1.8 BILLION IN PROFIT BEFORE TAX*
- 18% RETURN ON EQUITY*

DONE.

*Profits before exceptional/extraordinary items and, in the case of return on equity, after taxes.

Credit Suisse First Boston reported business unit results for 1997 as part of Credit Suisse Group's results announcement. They are what you'd expect from a world class investment banking firm.

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BOSTON**

THE GREATER THE RESOURCES, THE GREATER THE POSSIBILITIES.

COMPANIES & FINANCE: INTERNATIONAL

UBS-SBC MERGER NEW YORK STATE BANKING DEPARTMENT LODGES OBJECTION TO DEAL OVER QUESTION OF NAZI VICTIMS' DEPOSITS

Swiss bank deal threatened with delay

By William Hall
in Zurich

The merger of Union Bank of Switzerland and Swiss Bank Corporation into one of the world's top five banks could be delayed following a decision by the New York State Banking Department to oppose the merger.

The department has lodged a formal objection to the merger in a letter to the US Federal Reserve, citing "substantial concern" over

the welfare of the two banks' depositors. The Federal Reserve, the US central bank, has ultimate responsibility for approving the merger.

The department accused the two banks of "inattentive regard" for depositors who fell victim to the Nazi Holocaust, or their heirs, who have never received funds to which they are entitled. This "raises regulatory questions about the character and fitness" of the banks

concerned, the department alleged.

UBS said it was "very disappointed" by the New York development. The merger has already been cleared by the European Union competition authorities, and the Swiss cartel commission has until June 5th to make its decision.

Analysts had been expecting the merger to be completed by mid-June. John Leonard, of Salomon Brothers, said it was not

unknown for bank mergers to go ahead before final US approval had been granted.

The intervention of the New York banking authorities is the latest sign of the pressure on the Swiss banks to agree to a "global settlement" of the multi-billion-dollar class action suits they face from Holocaust survivors. Today, Alan Hevesi, the New York city comptroller, will host a meeting on whether to

impose sanctions on Swiss banks because of their alleged slowness in meeting the claims of dormant account holders.

George Pataki, the republican governor of the state of New York, said that before the two banks were allowed to merge, "they must convince New York's bank regulators and the Federal Reserve Board of Governors that they are doing everything in their power to rectify a great

injustice from the past".

Although the Federal Reserve has the power to approve the merger, the New York regulators have the power to revoke the two banks' local banking licences in New York, the world's most important financial centre.

Elizabeth McCann, acting New York banking superintendent, warned the two banks that the granting of a banking licence was "a privilege, not a right".

Norwegian paper group in talks on Thai buy

By Greg Mcivor in Stockholm

A trend among Europe's largest forestry groups to seek partners in Asia gained momentum yesterday when Norske Skog, of Norway, said it was in talks to acquire a majority stake in Thailand's only newspaper mill.

Norske Skog, one of Europe's biggest newspaper producers, said it had signed a letter of intent to acquire a stake in Shin Ho Paper. The acquisition would take place via a rights issue to which only Norske Skog would subscribe.

The agreement reflects a surge in interest among large European paper companies in the Asian market during the past year.

Enso, of Finland, said last week it was in talks with potential partners in southeast Asia, including a Thai company, over collaboration in fine paper. Sweden's Stora announced a big fine-paper deal in China in January.

Finland's UPM-Kymmene, Europe's biggest forestry group, last year entered a fine-paper joint venture with Asia Pacific Resources International, the Singapore-based manufacturer.

Jen Reimas, Norske Skog chief executive, said the addition of Shin Ho's newspaper mill at Sing Buri, north of Bangkok, would increase Norske Skog's annual newspaper production capacity to 2.1m tonnes from early next year. This would make it the world's third largest supplier.

Sing Buri has annual capacity of 120,000 tonnes. Norske Skog said the mill's machines corresponded to European standards.

Bufete is forced to take hard knocks

Mexican construction group misses out as foreigners move in, writes Henry Tricks

Nothing seems to be going right lately for Bufete Industrial, Mexico's second largest construction company.

The country is on its biggest infrastructure development drive in decades, but last year the three main government contractors - worth some \$3.75bn - slipped through Bufete's fingers.

Its best client is Pemex, the oil monopoly which this year embarked on a three-year \$2.5bn plan to boost production and refining. But a drop in crude prices forced the government on Tuesday to crimp its investments in energy for the second time this year, raising doubts about how much of the wish-list Pemex would complete.

Last week, Juan Alberto Zepeda Novelo, Bufete's pointman for oil development projects, was thrown in jail on money-laundering charges.

Mr Zepeda Novelo was a shareholder of a small bank that officials say was briefly owned by a Mexican drug cartel. Bufete immediately denied any money-laundering links, but it was nonetheless shaken by the scandal.

The knocks have brought a note of caution to Bufete executives, who in early 1997

had been promising investors their best year on record. In the past six months, its share price has tumbled 62 per cent.

The company acknowledges it may have unjustifiably primed expectations, especially in promising a \$55m payment Bufete says it is due for work completed at the Federal Electricity Commission (CFE). Three years

'It will continue to be a difficult year. What the analysts say is no lie'

later, the figure is still in dispute.

"The market is very sentiment-driven, and it expected a lot from Bufete," admits Jaime Zevada, the company's new head of investor relations.

"However, Bufete not only failed to win [big contracts last year], it also spent three years promising it would receive the CFE payment but it never did. So the sentiment is one of deception, and it's very understandable."

What went wrong reflects

the transformation in the way Mexico's budget-conscious government is carrying out big infrastructure projects.

Instead of funding them itself, the government is awarding concessions to companies that can build, finance and operate power-generation plants, natural-gas distribution networks, water-treatment plants and airports.

Mexican construction companies have had to team up with foreign partners in order to acquire the expertise and cheap funding that are not readily available at home.

Of Mexico's big three construction companies, Bufete has found the transition most awkward.

"It's the first time that for these large projects the name of the game is not engineering and construction so much as operating and financing," Mr Zevada says.

"The projects are going to the foreigners. We recognise that, and we also realise that's the market trend."

The one area where the old rules apply is oil. Pemex mostly provides its own financing for construction projects, and strict state control over sub-soil wealth

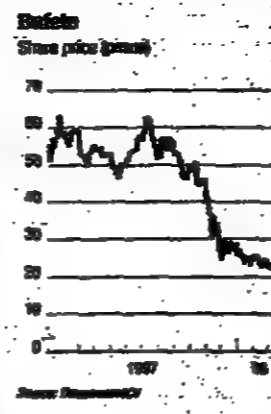
means it will also operate the new plants it plans to build.

Mr Zevada says the oil company's plans to upgrade three refineries, funding all the construction work itself, are likely to be unaffected by any cuts in energy sector investment. Bufete expects each project to be worth between \$500m and \$800m. They top its list of potential contracts this year.

The CFE, he says, will award four independent power producer projects this year, also providing opportunities. Bufete is planning to bid for two natural gas distribution projects in Mexico City, worth \$1bn combined. Last week, it narrowly lost a bid - with Gaz de France - for the natural gas contract in Monterrey, Mexico's main northern industrial city.

Combined with private construction projects, Bufete expects its backlog of work in progress to grow from \$552m last year to \$800m this. That, industry analysts say, is crucial.

Mr Zevada says the company is likely to post net losses in 1998, compared with a 45m peso (\$5m) profit in 1997. Operating margins will remain slim at 4 per cent and cash flow only just



Bufete share price (pesos)

Source: Reuters

covers debt servicing costs.

Particularly worrying to analysts is the company's \$250m debt. Mr Zevada says the company had bank lines worth \$400m that as a last resort could cover any debt-servicing needs. There was also cash to tide it over until October.

"You will never see Bufete default on any maturity," he says. However, he acknowledges it will be a tight squeeze. "It will continue to be a difficult year. What the analysts say is no lie. It's a very constrained balance sheet, and margins are low."

"This is going to be a big year of sowing seeds, depending on whether we win the big projects, we receive payment from the CFE and we keep healthy finances. In 1998, the outlook is much improved - better margins, sales and lower leverage."

SE-Banken unit buys into Finnish insurer

By Greg Mcivor

Skandinaviska Enskilda Banken, the Swedish bank, said yesterday it had purchased a large portion of a 15 per cent stake in Sampo, Finland's largest insurer, sold by MeritaNordbanken, the Swedish-Finnish bank.

Lars Thumell, SE-Banken chief executive, said the

bank was holding 9.99 per cent of Sampo's equity as a "financial investment" in anticipation of further restructuring of the Finnish financial market.

He said the shares had been bought by Trygg-Hansa, the Swedish insurer acquired by SE-Banken last year. The purchases took place during 1997 at an average

price of FIM140 per share. Sampo's most-traded A shares slipped FIM0.20 yesterday to FIM219.80. Speculation over restructuring helped lift SE-Banken's A shares by SKR6 to SKR123.

MeritaNordbanken, itself formed by a merger last year, announced on Tuesday it was buying a FIM1.1bn (\$198m) capital gain from the

sale of its entire stake in Sampo. The move is part of a programme of non-core asset disposals.

The bank said the shares had been sold in parcels to different buyers. Its stake in Pohjola, Finland's other large insurer, was also for sale "at the right price".

Analysts suggested Sampo could be an attractive part-

ner for SE-Banken if it expanded the geographical base of the insurance operations it acquired through Trygg.

Andrew Mitchell, European insurance analyst at Merrill Lynch in London, said the Finnish market was relatively "under-insured", with most savings held by banks.

REPUBLIC OF GREECE
MINISTRY OF NATIONAL DEFENCE
MINISTRY OF NATIONAL ECONOMY
REQUEST FOR PROPOSALS
FOR THE SELECTION OF
A SPECIALIZED STRATEGIC
MANAGEMENT CONSULTANT
FOR DEFENCE INDUSTRY

It is the intention of the Government of Greece to hire a special consultant, who, in cooperation with the Armaments General Directorate (AGD) of the Ministry of National Defence, will submit proposals concerning the state owned defence industries, Hellenic Aerospace Industry, Hellenic Arms Industry and Hellenic Powder & Cartridge Company.

In this context, the Government of Greece, represented by the Ministries of National Defence and National Economy, is interested in hiring a special consultant (legal entity or group of legal entities), who, in cooperation with the Armaments General Directorate (AGD) will submit proposals concerning the state owned defence industries, Hellenic Aerospace Industry, Hellenic Arms Industry and Hellenic Powder & Cartridge Company.

These proposals will include the policy and the measures necessary for the improvement of competitiveness of the state owned defence industries as far as cost and quality of products, modern technology and know-how and increasing the scope of production by introducing modern equipment are concerned with special emphasis to:

- New organisation and operation
- Introduction of modern managerial methods
- Restructuring of the industries and their production lines
- Full utilization of their potential
- Formulation of strategic targets:
 - Strengthening their export orientation
- Creation of joint ventures with Greek state owned or private and foreign companies to participate in bids issued by the Hellenic Ministry of National Defence and the wider public sector as well as in bilateral and international production programs.

f. Operation in a status of fiscal balance.

The Government of Greece requests proposals from consultative firms. The firms interested will have to be experienced in the field of defence industry, in Greece as well as abroad, and have a special knowledge of the Greek market and legislation. The firms or persons interested shall notify MOD/AGD of their interest within thirty (30) days following the last publication of this request in the Greek or foreign press (not later than 13.30 of the last day).

Those interested will have to submit the following:

- A list of the major managerial, organizational and financial consultative services offered during the last five (5) years, with special mention of the cost, the date and the name of the person or organization (public or private) accepting such services.
- A brief note on the measures taken to assure the quality of their services and the methodology used to complete their studies and research. In the case of a third person or group of persons being used to offer such services the third person or persons and their services should be specified.
- All documents in the proposal will have to be in Greek.

SELECTION OF SUCCESSFUL CANDIDATES

The Government of Greece will make a short list of all candidates meeting the requirements mentioned above according to its prerogatives.

Those selected will receive specific information on the services required and will be invited to submit their final proposals including the total cost of their services.

Those submitting proposals will have no right, claim or demand whatsoever upon the Government of Greece.

This announcement was written in Greek and translated in English. In case of disagreement, the Greek text will prevail.

MINISTRY OF NATIONAL DEFENCE
ARMAMENTS GENERAL DIRECTORATE
PAKINOS CAMP 1028 PAPAPOS

Prices for electricity determined by the
operation of the electricity market and
submitted independently

in England and Wales

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HERMÈS

Hermès: sales and earnings advanced in 1997.

In 1997, the Hermès Group's sales and earnings registered a 16% increase.

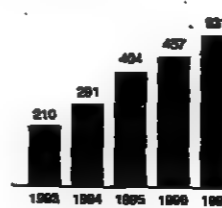
At the Supervisory Board Meeting held on 23 March 1998,
Jean-Louis Dumas, Chairman, presented the financial statements for the year to 31 December 1997.

The Group's consolidated turnover was FF4,858 million, or 16.1% higher than in 1996. At constant exchange rates, the increase would have been 11.8%.

The company registered uniform sales growth. In Europe (including France), where Hermès generates almost half of its turnover, sales tracked the general trend for the Group. In Asia, Hermès registered a 17% advance in turnover, thanks to a robust 37% rise in Japan. In the rest of Asia, sales slid 11%, mainly owing to a decline in Hong Kong, where the Group generates 5% of its sales. In America, sales were up 7%.

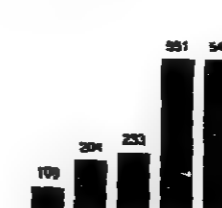
The Group struck a more even balance among the different Hermès business lines. Ready-to-wear, leather goods and watches registered robust advances ranging from 22% and 27%. Sales of silk goods remained virtually stable. Turnover from perfumes contracted 5% by comparison with 1996. Lastly, Hermès saw turnover growth of over 30% in its other business lines, driven by sales of jewellery, footwear, household items and tableware.

Operating profit advanced 33% on 1996. Gross margin remained stable. Overheads amounted to FF1,754 million, compared with FF1,579 million in 1996. Operating profit was FF1,003 million in 1997 compared with FF753 million in 1996.



NET PROFIT (FF)

Net profit was up 16%. After a higher tax burden (FF454 million compared with FF325 million in 1996), consolidated net profit was FF531 million, compared with FF457 million in 1996.



CASH FLOW (FF)

Cash flow was FF225 million, and was ample to cover a major investment programme of FF548 million. This sum includes FF225 million for the first stage of the acquisition of a real estate complex in Tokyo's Ginza district. During the year, Hermès opened ten new stores throughout the world and actively pursued the programme to renovate existing locations.

The Group's workforce has grown to nearly 4,000 employees. Hermès increased its staff by 200 in 1997.

In 1998, the Group is expected to continue expanding, albeit at a more moderate pace than in 1997. The tourist recession that took hold in Hong Kong several months ago affected our stores over the first few months of this year. In other countries, particularly Japan and France, sales remain on an uptrend and Hermès has undertaken numerous actions to continue to develop its business. The Group plans to open new locations in Europe, America and Asia. Its product lines will be enhanced by a large number of new ranges, including Rocobar, a fragrance for men, innovative materials and new handbag and luggage lines.

At the Annual General Meeting, the Board will submit a proposal to pay a dividend of FF3.70, or FF5.55 including tax credit. The Annual General Meeting will be held on Monday, 25 May 1998.

A message from R W Rowland, Lonrho's largest personal shareholder

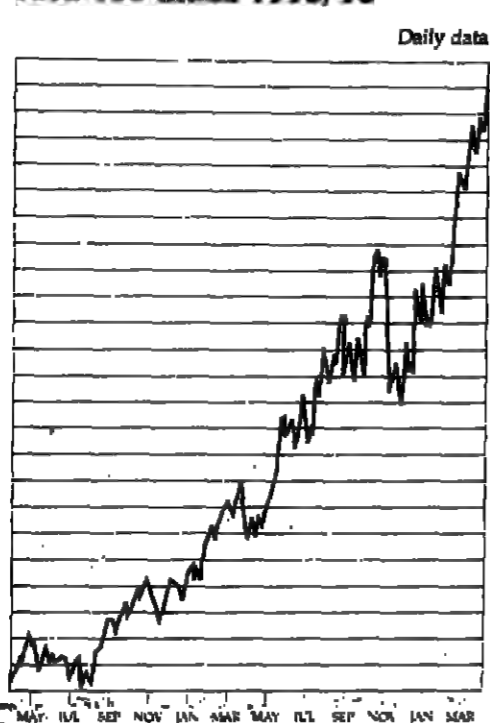
Lonrho Plc - think twice!

Dear Lonrho shareholder,

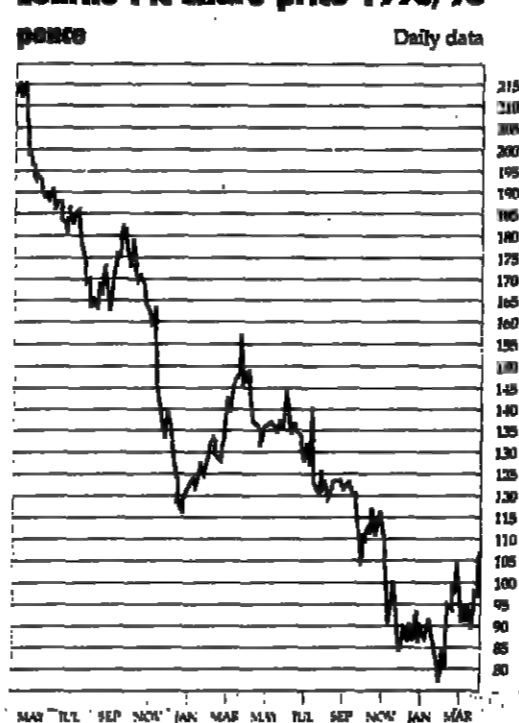
A mountain of paper has landed in your letterbox, sent by the directors of Lonrho. They want your votes again, to split a faltering company in two and execute a Share Buyback linked with the purchase of South African coal mines. Before voting please consider the essential facts:

- Lonrho's share price is down more than 25% for the year, against a soaring FTSE-100.
- Lonrho's profit (before exceptional items) went down to £48m in '97, the last year of the combined entity.
- The Tavistock-Share Buyback deals will raise debt at Lonrho to uncomfortable levels.
- Lonrho has lost a valuable claim against Gencor due to the extraordinary intervention of Mr Bock, Lonrho's former chief executive.
- Lonrho's board is now dominated by five non-executive directors. They do not add expertise or represent institutional investors.
- Analysts expect the Lonrho Africa share price to trade initially at a discount to Net Asset Value.

FTSE 100 index 1996/98



Lonrho Plc share price 1996/98



Shareholders will remember last year's AGM, when John Craven, the newly appointed chairman, promised to work in the interests of all Lonrho shareholders to create shareholder value. It hasn't happened.

THE BUYBACK

To achieve the board's desire, about £176.7 million in cash is going to flow out of our company to Anglo-American (or its designated recipients), present holders of the so called 'overhang' of Lonrho shares. A short while ago Anglo American bought about 50 million more of my shares at 200p; but now they are willing to sell at 106p. They have lost scores of millions on the investment and the lower price reflects their estimate of Lonrho's future, unless there are further understandings between the parties of which shareholders have not been informed.

Including £17 million Advance Corporation Tax*, £0.9 million stamp duty and the 3 pence dividend per share, the net price for the Share Buyback of the 166.7 million shares is nearer 120p than 106p per share.

None of the points made by Lonrho's directors in support of the Buyback go directly to improving the dividend or the share price, and I recommend shareholders pay attention to the caveat of Deutsche Morgan Grenfell, nursemaids to the proposal. They say they recommend it, having 'taken into account the Directors' commercial assessment' of the acquisition and the Lonrho Share Buyback. The same directors recommended the Metropole disaster, the futility of two years of negotiation over the Princess Hotels, the loss of Lonrho Sugar (built up over thirty years into a very good business), and now they have been responsible for the debacle over the Karee mine litigation. There has been one constant factor: Deutsche Morgan Grenfell acting through John Craven, today's chairman. Sir John and Morgan Grenfell came in with Dieter Bock and in my opinion a great part of Lonrho's misfortunes spring from their poor advice.

Despite our board's super forecasts, their combined holdings represent 0.1% of the issued capital, and have increased minimally in the last 3 years. They now forecast that buying coal and buying in Lonrho shares will 'enhance earnings' in the year ending 1999. They do not forecast higher dividends. The board has invited Sir Alastair Morton to join them and share his experience gained in the black hole of shareholder value, the Channel Tunnel. He has international expertise in facing furious shareholders.

COAL AND LONRHO

In a chain reaction with the Buyback, Lonrho is committed to taking the Tavistock coal mines from JCI for a hefty £167 million (R 1.378 billion) in cash, which after study actually looks like £181 million (R 1.5 billion). JCI is boasting to its shareholders about the figure.

Both transactions must go ahead, or neither. Both are up for approval on April 9th, the Thursday before Easter, at the Lonrho EGM.

It is quite a leap to get so heavily into coal in South Africa. At the moment Lonrho has 61% of Duiker coal, and our total coal interests have a market value of £52 million. We are looking at increasing our coal investments three or four fold, depending on the real value of Tavistock. The main reasons given for the proposed acquisition are synergies with Tavistock assets, which Lonrho could have bought directly from Shell South Africa one year ago. Since the announcement of the Tavistock deal Duiker's share price has dropped by 20% to R4 levels, reflecting how the market values the deal.

NEW LONRHO MINING

Leaving Princess Hotels aside (still forlornly at the altar) your company will effectively split in two if shareholders follow the board. Whether we do well or not depends entirely on this board's commercial judgement, as Deutsche Morgan Grenfell point out. Let's have a look at the main assets of New Lonrho Mining, described as a 'focused international mining group'.

- 33% (36 million shares) of Ashanti, which Lonrho does not manage or influence with two directors out of twelve. Market value £186 million.
- 73% of Western Platinum, where thanks to Mr Bock's questionable actions, the board is permanently split and market value reduced.
- 61% of Duiker Coal with a market value of £52 million, plus Tavistock coal if shareholders support it on April 9th.
- and some comparatively small gold mines in Zimbabwe, not all wholly owned.

It certainly does not yet look like a focused international mining group, as the board like to describe it to journalists. Mr Terence Wilkinson who formerly managed Lonrho South Africa is to lead 'New Lonrho Mining' to the uplands of international profit.

WHAT'S WRONG AT KAREE?

Lonrho has a junior partner, Gencor, in its platinum mine.

Gencor was given a shareholding of 27% in exchange for Karee, a neighbouring mine which has subsequently turned out to contain an enormous fault. Lonrho under my directorate held that the fault was known to the sellers but not disclosed to Lonrho, and had intended, by arbitration, either to reduce Gencor's shareholding in proportion to the gravity of the fault or to have financial compensation for it, which was expertly assessed to be some £44 million - a sum pretty near to the £48 million profit Lonrho Plc made last year and significant, regardless of whether it was settled in money or in shares. Gencor's board representation and influence would have declined, to Lonrho's advantage as a 'focused international mining group'.

In my view the whole of that position has been given away, without the authorisation of Lonrho's board, thanks to Mr Bock's extraordinary intervention. This leaves the future of the mine subject to the directors representing our minority partner. Mr Bock privily undertook to drop the Karee claim and (having sold all his Lonrho shares) later wrote a letter confirming this to Mr Gilbertson of Gencor. In the interim Lonrho sent out a circular about the Metropole deal which referred to Karee but did not disclose the true position; presumably the rest of the board did not know what Mr Bock had done. Nine days after his letter Mr Bock left the company's employ as chief executive. Our Lonrho board then tried to circumvent Mr Bock's letter but failed. An order was made against Lonrho by the South African court. For five months after writing the letter, while Lonrho defended the litigation that their chief executive had caused, Mr Bock was allowed to continue as a non-executive deputy chairman of Lonrho, until he left with a profit of over £130 million. A truthful account of Mr Bock's misconduct has never been given to shareholders.

CONFLICT OF INTEREST

Five non-executive directors, including two appointments by Lonrho's former chief executive Dieter Bock, Stephen Walls and Peter Harper, are now dominating the four executive directors on Lonrho's board.

Since becoming chairman of Lonrho Plc last year, John Craven, Deutsche Morgan Grenfell's former chairman, has brought in two friends, Roger Phillimore and Alastair Morton as non-executive directors. Craven, Morton and Phillimore share a South African background. John Craven is linked through the business interests of the Rupert family* to Gencor and Deutsche Morgan Grenfell have been recently appointed advisers to Gencor. It is difficult to present any one of the non-executive directors as a truly independent appointment.

LONRHO AFRICA - A DIFFICULT BIRTH

Lonrho Africa will operate in 14 countries, but sadly has no core business since Lonrho Sugar was sold. It will be hard to build it up again.

- The timing of the demerger is badly advised, given the '97 results of Lonrho Africa and the difficult markets Lonrho Africa is trading in at the moment.
- Lonrho Plc must leave Lonrho Africa with £70 million in cash to give it a chance.
- The failure to secure a listing on the South African Stock Market will add selling pressure to the Lonrho Africa share price.
- Black empowerment is not recognised at board level. The present board is under-qualified for the task facing them.
- Better and independent non-executives are needed. Stephen Walls from Albert Fisher Plc (shares down from 48p to 28p), where he is under pressure by shareholders for non-performance, is an incomprehensible choice.

I put a value of £500 million plus on Lonrho Africa had it included Lonrho Sugar, but reduce that figure by very much more than the £223 million achieved in a private sale of our estates because the steady income from sugar has also gone. Admirable as the other agricultural businesses are, they are not big earners and are far flung. The motor dealerships are franchises renewable at the will of the manufacturers.

Overall Lonrho Africa could be a promising company on a continent with a bright future, if it were provided with a far better board.

I close by saying that as the largest personal shareholder, I find it hard to see merit in these proposals. As the founder of Lonrho Plc, I see none at all. What about a name change?

Yours sincerely

Tim Rowland

R. W. Rowland

P.S. I have instructed my solicitors to pursue shareholders' interests in the case of the Bock/Gilbertson letter.

26 March 1998

*See page 94 of the Lonrho Circular on the Tavistock-Share Buyback proposals.
 *Lonrho's board always gave the impression that they could avoid this tax, by developing a structure which wouldn't trigger a Buyback until April '99, when Advance Corporation Tax is going to be abolished.
 *See page 13 of the Lonrho Circular on the Tavistock-Share Buyback proposals.
 *Shareholders will remember the JCI merger proposals in which Terence Wilkinson, Lonrho's director, being chosen by JCI as the future CEO of a merged company, had a clear conflict of interest.
 *The Rupert family is looked upon as being one of the controlling shareholders in Gencor.
 *See statement by the Lonrho board on the current trading situation in the Deutsche Morgan Grenfell Circular on the Lonrho Africa Demerger (pages 31-33) and the Lonrho Circular on the Tavistock-Share Buyback (page 14).

SOFTWARE INDUSTRY LEADER GIVES UNUSUAL PREVIEW OF QUARTERLY RESULT TO COUNTER UNCERTAINTY

Microsoft says earnings beat forecasts

By Louise Kehoe
in San Francisco

Shares of Microsoft jumped more than 5 per cent in early trading yesterday after the software industry leader said it would beat Wall Street expectations with earnings of about 48 cents a share for the quarter ending March 31.

In an unusual move, Microsoft previewed its third-quarter results after the close of trading on Tuesday, Greg Maffei, chief financial officer, said earnings

would be 4 cents or slightly more above the consensus of Wall Street analysts' projections, which stood at 43 cents a share. In the third quarter of last year, Microsoft earned \$1.04bn, or 40 cents a share, adjusted for a subsequent stock split, on revenue of \$3.21bn.

Microsoft had decided to counter uncertainties after recent profit warnings issued by other companies in the personal computer sector, Mr Maffei said. These have included Intel and

Compaq Computer. While these warnings had led some analysts to suspect slowing growth in PC sales, Microsoft had not seen any drop in revenues from PC manufacturers, he said.

Although Asian markets remained weak, there was "some evidence that they are not getting weaker, but little evidence of improvement".

Microsoft's third-quarter revenues had been boosted by strong sales of Office, its business application products, and strong sales in

Europe, he added. However, Mr Maffei said: "We continue to see solid growth, but growth is slowing, so people should not take this quarter as a harbinger of future quarters."

Growth in the third quarter would be less than 30 per cent he noted, compared with an average growth rate of about 50 per cent in recent quarters. Still, the company expected fourth-quarter earnings to be "a few pennies above" analysts' estimates of around 43 cents

a share. Growth in the current quarter was likely to be higher than in subsequent calendar 1998 quarters, he said. "This quarter could produce the highest earnings per share of any 1998 quarter," Mr Maffei said.

Analysts were sceptical, because Microsoft has often expressed caution about future results only to exceed expectations. Microsoft shares were trading at \$89 in mid-session, up \$4, or 5 per cent from Tuesday's close.

● Shares of SCom, the computer networking equipment manufacturer, dropped by 3 per cent to trade at \$36½ in mid-session yesterday after the company reported lower-than-expected earnings.

Net profits for the third quarter, ending March 1, were \$12.9m, or 4 cents a share, on revenues of \$1.25bn. A year ago SCom recorded earnings of \$179.1m, or 54 cents, on revenues of \$1.45bn. The latest results include a \$9.9m acquisition charge.

Caracas plans relaunch of aluminium sale

By Raymond Collin in Caracas

The world's leading aluminium companies are to make a second attempt, under new conditions, to acquire Venezuela's troubled aluminium complex, one of the world's largest.

The Venezuelan government pledged to relaunch the sale it suspended yesterday within two months, after the last remaining consortium, led by Billiton of the UK, withdrew on Tuesday.

"We are coming back with redoubled determination that will allow a transparent culmination of this process," said Alberto Poletto, head of FIV, the privatisation agency.

"Far from a defeat, this could well be a triumph beyond what [yesterday's] sale would have been," he said, adding that Rafael Caldera, the country's president, was determined to see the sale through.

Mr Poletto said the government would take into consideration the suggestions made by the three international consortia, which included Alcoa and Reynolds of the US, Alcan of Canada, and Norsk Hydro of Norway. These groups successively withdrew from the bidding process, objecting to the base price of \$2.1bn, high energy costs, and labour and environmental obligations.

Mr Poletto said the Billiton-led consortium had

sought last-minute demands that were impossible for the government to meet.

However, the government also emphasised that the terms of the sale had been known for months and established with the consent of the potential investors. "It would have been very unfair to change the terms of the contract for one consortium, when the other two had already withdrawn," said

Waldo Negrón, privatisation co-ordinator at the holding company CVG. "You have to offer the same rules of the game to all."

"Given the situation, the government's decision to relaunch the sale under new conditions is the most appropriate decision," said Francisco Natera, head of Fedecaracas, the industry federation. "But it needs to happen swiftly."

Critics said the government had overplayed its hand, demanding a base price above market value. Now it faces the politically difficult task of adjusting the minimum bid price and possibly reducing the labour and environmental obligations, which will require consensus among unions and opposition parties.

Mr Negrón said: "The outlook is quite bleak for the remainder of the year." Contractual modifications require congressional approval - difficult to obtain in an election year.

TELECOMS MOVE COULD LEAD TO A WAVE OF INDUSTRY CONSOLIDATION

Telus confirms AT&T talks

By Scott Morrison in Toronto

Canada's telecommunications industry is in upheaval after Telus, the Alberta-based local telephone company, confirmed it was in talks to form a "business combination" with AT&T Canada Long Distance Services.

Reports suggested that Telus could acquire two-thirds of AT&T Canada, which a telecoms analyst valued at C\$1bn (US\$704m).

However, it is likely that such a combination would be the first move in a wave of consolidation in Canada's telecoms sector, which comprises 11 local service providers and several long-distance competitors. Analysts say the fragmented industry is not able to achieve the economies of scale experienced in more mature telecoms sectors in other countries.

Analysts believe that Bell Canada, the country's largest phone group, will respond to the talks by launching a bid to acquire Telus to keep intact the 11-member Stentor alliance of local telephone carriers. Bell Canada, wholly owned by BCE, has conceded that the alliance "will need to be realigned" and indicated it was in talks with other members to determine how best to respond.

"If this deal goes through, Stentor will break up unless BCE can buy out the members," said Dvay Ghose of James Capel Canada.

However, BCE would not comment if it had



Breaking up: Canada's Stentor alliance is in danger

approached Telus in the wake of the Telus/AT&T announcement.

The prospect of sector consolidation lifted Canadian telecoms stocks for the second day. BCE was up C\$2 at C\$89.25 in early trading yesterday, while Telus had gained C\$2.65 to C\$43.05.

Even if the merger talks break off, analysts believe developments have permanently damaged the relationship among Stentor members, which have operated under an unwritten agreement that they do not encroach on each other's territory. An operational merger between Telus and AT&T Canada would pit the Alberta carrier against other Stentor members.

Telus, Canada's third largest local service provider, has signalled it is unsatisfied with its position in the Bell Canada-dominated alliance.

An operational merger between Telus and AT&T would create a formidable provider of local and long-distance services, enabling the combined company to operate outside Alberta.

Telus would immediately obtain a national high-speed network with which it could attack the Ontario long-distance market. That would put it into direct competition with Bell Canada, its alliance partner. AT&T, which is one-third owned by its US parent and two-thirds owned by three Canadian banks, would gain access to a local exchange with 1.8m phone lines which would form a solid client base for its long-distance service.

Telelobe, the Canadian overseas network operator 23 per cent owned by BCE, would also suffer as a result of a Telus takeover of AT&T

Canada. Telelobe is scheduled to lose its monopoly on overseas calls in October and while it recently signed three-year agreements guaranteeing it a minimum amount of traffic from Stentor members, it would eventually suffer the loss of Telus' long-distance traffic if the "combination" happens.

Analysts say consolidation could involve Canada's cable television companies. Should Bell Canada face a Telus/AT&T alliance, it could pursue Shaw Cable in a bid to acquire its broadband network in Alberta.

Analysts suggested regulators would be likely to approve a Telus acquisition of AT&T Canada, because it is consistent with the government's aim to foster more competition in the sector. A Bell Canada bid for Telus, however, could pose problems for regulators.

Lehman takes top spot in M&A consultancy

By William Lewis
in New York

Lehman Brothers, the investment bank, has moved to the top of the league table for US mergers and acquisitions advisory work, helping the bank to record earnings per share in the first quarter of 1998.

According to Securities Data, the leading M&A data consultancy, Lehman has advised on deals worth \$65.5bn announced in the US

in the year to date, giving it a market share of 29.1 per cent.

Merrill Lynch ranked second, with announced US deals worth \$62.8bn. Credit Suisse First Boston is third, having advised on \$40bn of takeovers.

The US is the world's most valuable M&A market. Over the past three months, Lehman's M&A department, under the management of Steven Wolitzer, has advised companies involved in some

of the largest takeovers in the US market.

It advised Digital Equipment on its \$9.6bn merger with Compaq Computer, and Washington Mutual on its \$9.9bn acquisition of HF Ahmanson.

Analysts said yesterday that Lehman had traditionally been seen by investors as a fixed-income trading house. However, two years into its attempt to move into higher-margin investment banking activities such as

equity trading and M&A, Lehman's efforts appear to be paying off. In the first quarter of 1997, Lehman ranked ninth in announced US takeover advisory work, while for the full year it ranked fifth.

Lehman yesterday announced net income of \$187m, or \$1.44 per common share, for the first quarter to February - a 30 per cent increase on the \$144m net income, or \$1.16 per share, achieved in the same period

last year.

According to First Call, the Boston-based research group, analysts had forecast that Lehman would declare earnings per share of \$1.20 for the quarter.

In morning trading in New York, Lehman's shares rose \$1½ to \$74½.

Net revenues for the first quarter were \$1.045bn, an increase of 13 per cent on the \$925m achieved in the first quarter of 1997. Investment banking revenues were

\$348m, compared with \$240m, of which \$96m came from M&A advisory work. Non-interest expenses were \$770m, against \$706m a year earlier.

NEWS DIGEST

INTERNET

Netscape creates arm to boost website presence

Netscape Communications has created a division aimed at transforming its website into a full internet service to compete with companies such as Yahoo! and America Online. Netscape's Netcenter website is one of the busiest on the internet with 3.8m registered users. Over the past six months it has become a growing source of revenues for the software company as information and service providers and advertisers pay fees to be on the site. In the fourth quarter, ended in December, Netscape generated \$21m, or about 25 per cent of total revenues.

Mike Homer, formerly executive vice-president of sales and marketing and who was yesterday appointed general manager of the new division, said Netscape aimed to draw on the 60m users of its browser software. Louise Kehoe, San Francisco.

AEROSPACE

Northrop takes \$180m charge

Northrop Grumman, the US aerospace group at the centre of a confrontation between Lockheed Martin and the federal government, will take a pre-tax charge of \$180m against first-quarter earnings. Part of the charge, which is likely to take the group into a loss, according to analysts' calculations, was to cover the cost of vesting restricted stock which became void for issue after shareholders approved the stalled merger with Lockheed last month, the company said.

While analysts had estimated Northrop's first-quarter earnings at \$1.44 a share, the company said the charge would reduce the figure by \$1.70. Christopher Partos, Los Angeles.

PATENTS

Imatec sues Apple Computer

Imatec, the technology developer, has filed a lawsuit against Apple Computer, alleging infringement of three patents and seeking \$1.1bn in damages. The suit alleges that Apple infringed Imatec patents "by its making, using, and/or selling its Color Sync colour management systems and including others to do so".

Apple officials were not immediately available for comment. The patents in question were issued to Haruch Shalit, Imatec president, who granted exclusive licences to his company, Imatec, said Reuters, New York.

GOLDMAN SACHS

Mondale appointed adviser

Goldman Sachs has named Walter Mondale, former US ambassador to Japan, its senior adviser on Japanese issues. Mr Mondale, US vice-president from 1977-81 and unsuccessful Democratic presidential candidate in 1984, is the latest heavy hitter to deploy his public experience for the investment bank. Peter Sutcliffe, former European commissioner and first director-general of the World Trade Organisation, has been chairman of Goldman Sachs International since 1995.

Clay Harris, Banking Correspondent

PHARMACEUTICALS

Monsanto to sell optical unit

Monsanto, the US agribusiness, pharmaceuticals and biotechnology group, is to sell its optical products division to BMC Industries for \$100m. The business, based in California, makes optical lenses and employs about 285 people. The disposal is the latest by the St Louis-based company, as it refocuses on higher value-added products such as drugs or genetically-engineered crops. Nikki Tait, Chicago.

RETAILING

Wal-Mart tests smaller stores

Wal-Mart Stores, the world's biggest retailer, is planning to experiment with smaller discount stores at three locations in and around its home town of Bentonville, Arkansas. The stores will measure about 40,000 sq ft each, compared with an average of 92,000 sq ft for the group's existing stores.

The strategy is similar to that adopted by Sears Roebuck, the world's second biggest retailer, which is opening hundreds of neighbourhood stores across the US.

Wal-Mart has 1,900 out-of-town discount stores selling general merchandise, 440 Supercenters that sell groceries and fresh produce as well, and 440 Sam's Club membership warehouses. Richard Tomkins, New York.

PUBLIC NOTICES

NOTICE PUBLISHED BY THE SECRETARY OF STATE FOR TRADE AND INDUSTRY UNDER SUBSECTION 8(5) OF THE TELECOMMUNICATIONS ACT 1984

The Secretary of State hereby gives notice as follows.

1. She proposes to grant licences under the Telecommunications Act 1984 ("the Act") to Single (Europe) Ltd, Stance Telecom Limited, ON West Northern Germany Ltd AS, and to communications Limited, Tele Denmark AS, Transvision Communications Limited, UTG Communications (Europe) AG, PSNet Telecom UK Limited, DirectNet Telecommunications UK Limited and Stentor Communications Limited ("the Licensees") to run international telecommunication systems in the United Kingdom. The licences will be for a period of six months, thereafter being subject to revocation on one month's notice.
2. The principal effect of each licence will be to enable the Licensees to install and run telecommunication systems in the United Kingdom which may be connected to telecommunication systems outside the United Kingdom and to provide a wide range of international services but not any domestic services (i.e. services involving the conveyance of messages which originate and are subsequently transmitted in the United Kingdom) or mobile radio services. Each Licensee authorises the connection to a wide range of other systems, including domestic systems and earth orbiting apparatus.
3. Each Licensee will be subject to conditions such that section 3 of the Act will apply to it, thereby making each of the systems run under each licence eligible for designation as a public telecommunication system under section 3 of the Act. It is the intention of the Secretary of State to designate each of the Licensees' systems as a public telecommunication system.
4. The Secretary of State proposes to grant each licence in response to an application from each Licensee for such a licence because she considers it will help to satisfy demands in the United Kingdom for the provision of services of the type mentioned, will promote the interests of consumers in respect of the quality and variety of such services, and will maintain and promote effective competition between those engaged in the provision of telecommunication services.
5. Representations or objections may be made in respect of each of the proposed licences. They should be made in writing by 24 April 1998 and addressed to the undersecretary at the Department of Trade and Industry, Communications and Information Industries Directorate, 2.57 Gey, 151 Buckingham Palace Road, London SW1W 9SS. Copies of the proposed licences can be obtained free of charge by writing to the Department (Sec 0171 215 1721) or by calling 0171 215 1756.

Alan Proud
Department of Trade and Industry

26 March 1998

VOLKSWAGEN AG

Wolfsburg

Invitation to the Ordinary Annual Meeting of Stockholders

We have pleasure in inviting holders of ordinary and preferred shares to the Ordinary Annual Meeting of Stockholders to be held at 10.00 a.m. on Thursday, 4th June, 1998 at the Congress Centrum Hamburg, Am Dammtor, 20355 Hamburg.

Agenda:

1. Presentation of the confirmed financial statements, the consolidated financial statements, the Management Report and the Group Management Report for the year ended December 31, 1997, together with the Report of the Supervisory Board.
2. Resolution on appropriation of net earnings available for distribution.
3. Resolution on ratification of the actions of the Board of Management for the fiscal year 1997.
4. Resolution on ratification of the actions of the Supervisory Board for the fiscal year 1997.
5. Resolution on the conversion of nominal-value shares into individual share certificates (shares with no nominal value) at a ratio of 1:10, adjustment of the approved and potential capital stock, and the approved and potential stock, and the appropriate amendments of the Articles of Association.
6. Appointment of auditors for the fiscal year 1998.

Entitlement to attend the Annual Meeting of Stockholders and to exercise voting rights is restricted to stockholders, and with regard to voting rights holders of ordinary shares who, in accordance with the Articles of Association, deposit their shares or certificates of deposit of their shares from a bank for central depository of securities at the latest by May 28, 1998 at the depository designated below, at a notary or a bank for central depository of securities and leave them there until the end of the Annual Meeting of Stockholders.

The depository in Great Britain is SBC Warburg Dillon Reed in London. It is also permissible, with the agreement of a depository, to hold the shares at another bank and block them until the end of the Annual Meeting of Stockholders.

Wolfsburg, March 1998

The Board of Management

New Issue

This information appears as a matter of record only.
The bonds described below have already been offered for sale.

March 25, 1998

Allianz

Allianz Finance B.V.
Amsterdam, The Netherlands

DM 2,000,000,000
5% Bearer Bonds of 1998/2008
under the unconditional and irrevocable guarantee of

Allianz Aktiengesellschaft
Issue Price: 101.025 %

Dresdner Kleinwort Benson
Dresdner Bank Aktiengesellschaft

Bayerische Vereinsbank AG

Deutsche Morgan Grenfell
Deutsche Bank Aktiengesellschaft

Goldman, Sachs & Co. oHG

J. P. Morgan GmbH

RASFIN SIM S.p.A.

SBC Warburg Dillon Reed
Schweizerische Bankverein (Deutschland) AG

BANKING SALARY, CASH AND SHARE PAYMENTS INCREASED DESPITE 29% FALL IN EARNINGS AND HEAVY LOSSES FROM UNRAVELLING OF BZW

Barclays executives paid large bonuses

By George Graham, Banking Editor

Executives at Barclays, the UK banking group, accepted large bonus payments last year in spite of a 29 per cent drop in earnings per share and substantial losses in unravelling the group's BZW investment banking subsidiary.

Martin Taylor, chief executive, took salary, cash bonus

and shares totalling \$976,000 (\$1.63m), up \$40,000 from 1996, in spite of the decline in Barclays' profits performance. Mr Taylor also exercised the right to a bonus granted in 1994 worth an additional \$762,000.

Andrew Buxton, chairman, increased his total package from \$574,000 to \$579,000. Sir Peter Middleton, deputy chairman, received a cash bonus of \$120,000 on top

of his \$296,000 salary, taking his total rewards to \$455,000 compared with \$438,000 in 1996.

Observers said that, as chairman of BZW, Sir Peter might have been expected to take some responsibility for the \$466m loss Barclays took on the sale of its equities and advisory business and the \$218m operating loss it accumulated in that business over the year.

Barclays also paid Bill Harrison £1.2m in salary and benefits last year. He became BZW's chief executive in September 1996, receiving £1.5m on joining. He left in October 1997 after the decision to sell its equities operations. In total, Barclays paid \$4m for Mr Harrison's 18 months of service.

Barclays' payments contrast with the policy of National Westminster Bank,

where Lord Alexander, the chairman, and Derek Wanless, chief executive, asked not to be considered for bonuses in light of the group's poor performance.

Barclays' results were not as poor as NatWest's, but represented a substantial decline.

"I know the profits were lower than the year before, but they were still good profits," a Barclays official said,

adding that the executive directors' pay packages were "within market norms".

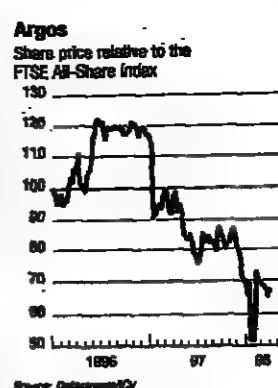
Bank officials said the increase in executives' pay had not exceeded total shareholder returns in the past three years.

Returns to Barclays shareholders in 1996-97 totalled 186 per cent compared with 84 per cent for companies in the FTSE 100 index as a whole.

COMMENT

Argos

A little tender loving care from a seasoned retailer has left Argos looking healthier. The claim that catalogue retailing was outdated was always overstated. It was more a case of a decent concept suffering from a serious deficit of retail skills. New man Stuart Rose's revised strategy sets about correcting this. It is hardly revolutionary - a better range of products, a shift to higher margins, an improved shopping experience - but no revolution is required. Coupled with a respectable trading statement, Mr Rose has done enough to ensure that hostile bidder GUS will not be allowed to buy on the cheap. Indeed, by unravelling the joint-venture agreement with Littlewoods, he has done more. Selling clothes and home furnishings to Argos's 14m customers is potentially a big new business. The fact that it also involves Littlewoods, GUS's main competitor, only adds to its value. Argos's freedom is still far from guaranteed, but GUS will need to raise its 570p bid if it is to prevail. Investors should hold on to their shares.



Utilities

Thankfully, the UK government's green paper on utility regulation has proved a damp squib. Populist ideas aired in opposition - like sharing excess profits - have been scrapped. And some of the remaining proposals look modestly useful. Take, for example, the requirement for the government to spell out its social and environmental objectives in relation to the utilities. That might look like dangerous meddling in the independence of the regulators. But it could make transparent a process that already takes place through nudges and winks. Moreover, any social measures that have significant financial implications for companies or consumers will need to be debated and voted on in parliament. That is right, as they can in effect amount to a tax.

If there is one niggle, it is the idea for a mechanism to hand windfall profits that land in companies' laps to customers. The government seems to assume these are always profits. But what happens if there are windfall losses? To be symmetrical, customers should pick those up too - hardly a clever idea. Fortunately, the government's thinking seems so woolly that the scheme may be quietly shelved.

Renewing affection for GEC

Roger Taylor examines the reasons behind the group's share price recovery



Opening up: Lord Simpson

After eighteen frustrating months, the pieces may be beginning to fall into place for Lord Simpson, managing director of General Electric Company, the UK electronics and defence group.

The stock market certainly seems to believe so. When he took over, in September 1996, the share price was 380p. Last month, it was still at that level, despite months of what one director described as "the hardest work I have ever done in my life".

Now all of a sudden things are happening. In the last month the price has leapt from 373p to 466p at yesterday's close. The excitement is partly belated recognition for what has already been achieved. But there is also growing anticipation at the next move.

Last month the company arranged a euro-denominated credit facility for £6bn (about \$6.7bn) to add to its cash pile of about (\$1.6bn). The deal was finalised yesterday giving the company the firepower it needs to carry out its plans.

Petrol was thrown on the fire of speculation when news came that the merger of US defence groups Lockheed Martin and Northrop Grumman had been blocked. Suddenly huge new oppor-

tunities seemed to open up for GEC. At the least, it could hope to buy some of Lockheed and Northrop's businesses. At best, it might bid for Northrop.

Prior to this month, GEC's weak share price reflected a view that the company was moving too slowly and was being outmanoeuvred.

Lord Simpson had left investors waiting nine months after taking up the job before laying out his strategy last July.

By the start of 1996 several key planks in the strategy had yet to be revealed. Investors were beginning to tap their fingers. Some argued that Lord Simpson was a steady-nerved negotiator waiting until he saw the whites of the enemies' eyes before firing. Others asked whether he was dozing on the job.

GEC protests that it has been making progress.

The GEC-Alsthom heavy engineering joint venture with Alcatel-Alsthom of France is due to be floated later this year.

The company has also started negotiations with Siemens of Germany over its other large joint venture - the GPT telecommunications business.

The UK industrial division has been largely disbanded.

tion, some analysts have suggested this is no more than a second best option. Analysts have also worried that politics have not been going GEC's way. The French, UK and German governments have agreed on the need for consolidation in the European defence industry. BAE has been putting itself forward as the natural hub of defence aerospace. In return, it is thought the French might demand dominance of electronics.

The French government plans to create a defence business built around Thomson-CSF, incorporating telecommunications and space from Alcatel-Alsthom, electronics from Dassault, and satellites from Aerospatiale.

Such notions infuriate GEC. John Mayo, finance director, insists that GEC is going to be "the only European global defence electronics business".

In his favour is the fact that, although Thomson-CSF is bigger than GEC in terms of defence electronics sales, GEC is far more profitable. Furthermore it has substantial business in the US. In contrast, Thomson-CSF's relations with the US defence establishment are relatively poor.

A big acquisition in the US could shift the tables strongly in GEC's favour, and transform the outlook for the industry as a whole.

Argos ups GUS takeover ante

By Penny Hargrave

Argos yesterday raised the stakes in its battle against the £1.6bn (\$2.6bn) cash bid from mall owner, Great Universal Stores, with plans to launch a fashion and furnishings catalogue in a joint venture with its predator's rival, Littlewoods.

Stuart Rose, the new chief executive of Argos, yesterday set out his strategy to modernise the high street catalogue retailer.

Unveiling a colourful, new-look catalogue, Mr Rose pledged to increase Argos's gross margins by one percentage point, introduce a comprehensive home shopping service, revamp the product range and improve the store environment - all without increasing costs.

He also revealed that Argos was in talks with the clothing retailer, Arcadia,

"All these things will enhance shareholder value in the short, medium and long term if shareholders decide to stay with us," he said.

Mr Rose reported that sales in the last 12 weeks to March 21 were 11.5 per cent ahead. "The core business is not the moribund, defunct business that GUS says it is," he said.

Mr Rose said the joint venture catalogue, to be called Argos Extra, would initially contain fashion from Littlewoods' successful Index Extra direct-mail business. Eventually, it would build up products available only to Argos customers.

However, if GUS wins its 570p a share bid, the joint venture would be abandoned.

GUS accused Argos of entering a "shotgun wedding" with Littlewoods.

EasyJet buys 40% Swiss stake

By Michael Slaughter, Aerospace Correspondent

EasyJet, the low-cost airline, will announce today that it has bought a 40 per cent stake in TEA Switzerland, a Swiss charter carrier with four leased Boeing aircraft.

The purchase, for an undisclosed sum, comes as EasyJet faces increased competition from the planned launch of Go, British Airways' low cost carrier. EasyJet is also concerned about congestion at its base at London's Luton airport.

EasyJet has an option to increase its stake in TEA to 90 per cent, which will be permitted if Switzerland con-

cludes an "open skies" agreement with the European Union.

EasyJet wants to relaunch TEA as a low-cost, no frills operator called EasyJet Switzerland. But Stalios Hajiloannou, EasyJet's chairman, said yesterday that "a lot of work has to be done to turn the company into a low cost scheduled carrier".

Mr Hajiloannou said he would be asking the International Lease Finance Corporation, the Los Angeles-based company from which TEA leases its aircraft, for a reduction in lease rates.

He said that EasyJet would also be asking Geneva airport for lower charges in

return for the establishment of new services. Geneva has suffered from the loss of several Swissair services, which have been moved to Zurich.

EasyJet will start using one of TEA's aircraft on its Geneva-London route in May. If TEA's costs can be reduced sufficiently by October, the airline, which has 300 employees, would begin low-cost flights from Switzerland to other European cities.

There would include flights from Zurich and Geneva to London and from Switzerland to Nice, Barcelona, Amsterdam and Glasgow. Mr Hajiloannou said TEA would also challenge

Swissair on the Zurich-Geneva route.

Mr Hajiloannou, the heir to a Greek shipping fortune, launched EasyJet at Luton in 1995, attracted by the UK's flexible labour force and low costs. While determined to keep the company's headquarters in the UK, he has also been looking for additional European hubs.

An attempt to acquire Air Holland and establish a new base in Amsterdam failed recently when minority shareholders exercised their right of first refusal and bought the company instead. He has also expressed an interest in establishing a hub in Athens.

Quarry swap boosts Tarmac

By Jonathan Gathir

A recovery in construction and better building products prices helped Tarmac, the UK's largest aggregates group, raise 1997 profits to the top of UK expectations.

Pre-tax profits grew 89 per cent to £120m, with the increase far greater when an exceptional charge of £66m in 1996 for restructuring was included. Tarmac swapped its quarrying side for Wimpey's quarrying and construction in November 1995, prompting a wholesale reorganisation.

The company said the shake-up had unlocked annual cost savings of £40m, twice original estimates. It announced a final dividend of 2.65p, making 5.65p (5.5p) for the year - the first increase since 1990.

Sir Neville Simms, group chief executive, said "It was important to reward shareholders for staying with us."

"This group is finally getting it together," said one analyst.

Tarmac raised operating profits from construction 83 per cent to £29.2m. Margins on sales grew from 1 to 1.8 per cent, ahead of industry norms and partly the result of taking on fewer loss-making projects.

Operating profits from heavy building materials jumped 19.4 per cent to £142m after price increases and a margin improvement from 10.5 to 11.9 per cent on the back of cost-cutting. Sales rose just 5 per cent to £1.9bn.

Sir Neville said Tarmac could spend at least another £45m on buildings materials acquisitions in 1998, bringing the total above £55m.

Group turnover rose 4 per cent to £2.77bn. Gearing fell from 45 to 37 per cent. Earnings per share before exceptional items grew 2.8p to 8.3p. The shares rose 7p to 119p.

LucasVarity buy signalled

By Andrew Edgecliffe-Johnson

LucasVarity has been signalled to be a takeover target by a number of existing bilateral arrangements. At present it is unengaged.

The group is eager to strengthen its position in the automotive components and aerospace markets through acquisitions, but recent speculation that it could bid for the brakes division of ITT in the US is wide of the mark.

The overlap between the US industrial group and LucasVarity would create insuper-

able anti-trust problems. Victor Rios, LucasVarity's chief executive, has cautioned analysts that sales growth in the full year would be modest, and that sales would drop in the fourth quarter because of a fall in the number of working days. LucasVarity, which was formed in September 1996 by the combination of Lucas Industries of the UK and Varity Corporation of the US is expected to meet its target of \$40m merger-related savings in 1997.

ment yesterday, but it is a revolving facility to replace a number of existing bilateral arrangements. At present it is unengaged.

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ALTRAN TECHNOLOGIES

IS NOW QUOTED ON THE PARIS MAIN MARKET

WHY THE "RÈGLEMENT MENSUEL" ?

Since its introduction on the Second March in October 1987, Altran Technologies has:

- increased its market capitalisation 36-fold to 7,466 MF on the 18th of March 1998,
- raised average daily volume of transactions to over 10 MF in the first quarter of 1998,
- boosted turnover 16-fold to 1,911 MF in 1997,
- raised net result before amortization of goodwill approximately 10% each year,
- expanded to 10 European countries,
- Altran Technologies is the French leader in Total Shareholder Return (TSR) over 5 years, according to a May 1997 Boston Consulting Group survey. The annual actual TSR is 45%.

This figure measures overall share profitability as it includes its buying price, paid dividends and complete added value.

"After 10 years as a listed company Altran Technologies has been promoted to the Règlement Mensuel market."

HOW WILL THE TRANSFER WORK ?

- A March 25th transfer,
- A four-way stock split from 2,447,710 shares to 9,790,840,
- Thus a quoted price automatically divided by 4.
- Each Altran Technologies shareholder will receive 3 new shares for each previously held share.

A positive transfer for shareholders, with more liquidity and an increase in the number of transactions.

A positive transfer for the company, favouring its international development and raising its profile.



Sea Containers refocuses

By Charles Babin, Transport Correspondent

Profits from Sea Containers' passenger transport and leisure activities combined exceeded those from container leasing for the first time during 1997, the company said yesterday.

Container leasing profits fell but this was the result of a fall in rates rather than a drop in utilisation.

The shift in profits emphasised the extent of Sea Containers' diversification away from its container business and came six months after the company announced the container operations were being put into a joint venture with GE Capital Services.

Net profits fell to \$6.9m (\$7.9m) in the final quarter on turnover which rose to \$355.2m (\$299.9m). Net earnings per common share fell to \$0.25 (\$0.30).

Net profits in the year as a whole rose to \$42m (\$30.6m) on turnover which rose to \$1.35m (\$971.7m). Net earnings per common share rose to \$2.07 (\$1.20).

LEGAL NOTICE

PINE TOP INSURANCE COMPANY LIMITED (IN A SCHEDULE OF ARRANGEMENTS) Registered Office: 120 Victoria Road, London EC2A 4DF. Phone: 0171 600 9629 Fax: 0171 600 9430. CLAIM SUBMISSION DEADLINE: 30 APRIL 1998.

NOTICE IS HEREBY GIVEN that conditions of the above named company are required, under the terms of the Scheme of Arrangement, to file proof of claims before the claims submission deadline of 30 April 1998.

All known creditors have been provided with the required claims forms, however, if you believe you may be a creditor of the above named company and have not received a claim form, please contact the company at the above address.

All completed claims forms must be received by the company, at the above address, no later than the 30 April 1998. Proof of claim forms not received by that date will not be considered to seek for any distribution that becomes payable under the Scheme of Arrangement.

THE FIRST MEXICO INCOME FUND N.V.

Incorporated in the Netherlands Antilles

NOTICE OF DIVIDEND

Shareholders are informed of a dividend of US\$0.40 per share of Common Stock to holders of record as of March 31, 1998. The ex-dividend date was March 26, 1998. The dividend will be paid on April 15, 1998. Payment of the dividend on the bearer shares will be made against surrender of coupon No. 31 detached from the share certificates which for this purpose shall be lodged at:

MEESPIERSON N.V.
Rokin 55
1012 KK Amsterdam
The Netherlands

which acts as Paying Agent on behalf of the undersigned.

March 26, 1998.

MEESPIERSON TRUST (CURAÇAO) N.V.

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LONDON STOCK EXCHANGE

Valuation and interest rate worries upset leaders

MARKET REPORT

By Steve Thompson,
UK Stock Market Editor

The London market's upward march, which saw the FTSE 100 move briefly back through the 6,000 level, was halted yesterday as institutions were reminded of the potential for further increases in domestic interest rates and of stretched valuations for UK stocks.

But there were no such restrictions for the market's second and third-tier stocks which maintained their seemingly relentless

advances to new intra-day and closing peaks.

One of the leading strategy teams agreed with the more cautious view of the market.

NatWest Markets' Bob Semple and David McBain said in their latest market commentary: "Valuations have become more demanding and there are considerable risks that corporate profits will disappoint on the downside. Moreover, the latest institutional cash flow data are also weaker than expected. Our conclusion is that the market is now due for a period of consolidation."

As the dust settled on

another day of rather erratic movements in the leaders,

the FTSE 100 index finished 15.9 off at 5,967.8, having swung in a near-50 point arc.

Prices raced ahead at the outset before coming off to hit the day's low point just before the close. There was some relief that the gilt auction proved successful, with the offer three times covered.

At its best, the index moved through the 6,000 mark and touched 6,007.6, a gain of 23.8. The session low was 5,858.5. The market was alerted to the bearish signal from the yield on the All-

Share index, which is at its lowest level since the first world war.

That was seen by market-makers as a sign of downside potential in the near future. "What it tells us, as if we didn't need telling, is that the market is running straight towards a wobble. The market keeps going up and is being driven by weight of money which you simply cannot argue with. But if that inflow suddenly stops then there will be short-term problems," was the view of one market-maker in London.

He said there were plenty

of potential problem areas but insisted any turbulence would most likely start in bond markets.

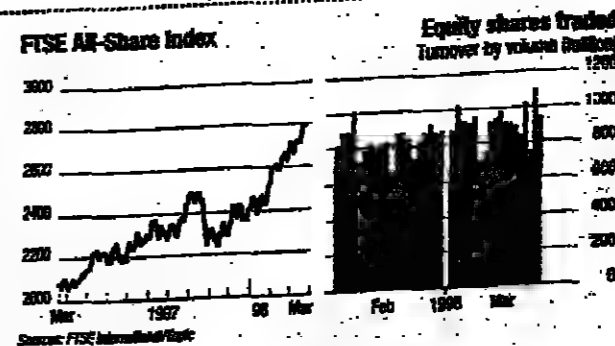
The next meeting of the US Federal Reserve's open market committee is next week. And a highly regarded economist, Gavyn Davies of Goldman Sachs, told a House of Commons select committee on Tuesday that UK interest rates needed to rise to ensure the government's inflation target was met.

The second-line stocks, meanwhile, moved higher throughout the day. The FTSE 250 index eventually settled 21.1 up at a new

intra-day and closing peak of 5,544.4. Similarly, the FTSE SmallCap closed the session at new intra-day and closing records, up 12.4 at 2,626.2.

The 250 index was helped along by a spate of positive company news items, with House of Fraser, the department store chain, posting better-than-expected profits and Barratt Developments continuing the list of excellent profits performances from the housebuilders.

Turnover in equities came in at \$60.4m, split evenly between the FTSE 100 stocks and others. Shell was the busiest stock in the Footsie.



Indices and ratios	FTSE 100	FTSE 250	FTSE All-Share	FTSE 100/FTSE 250	FTSE 100/FTSE All-Share	FTSE 250/FTSE All-Share
FTSE 100	5967.8	-15.9	5792.2	-6.5		
FTSE 250	5544.4	+21.1	5225.5	-32.2		
FTSE All-Share	5967.8	-4.2	5225.5	-13.0		
FTSE 100/FTSE 250	2705.5	-3.00	2705.5	2.15		
FTSE All-Share yield	2.77	2.77	2.77	2.16		

Best performing sectors

1. Water	+2.0	1. Oil	+1.2
2. Retailers	+1.1	2. Alcoholic Beverages	+1.5
3. Retailers	+1.0	3. Pharmaceuticals	+1.4
4. Transport	+0.9	4. Tobacco	+1.4
5. Investment Trusts	+0.8	5. Oil Exploration	+1.3

Worst performing sectors

1. Water	-1.2	1. Oil	-1.2
2. Retailers	-1.1	2. Alcoholic Beverages	-1.5
3. Retailers	-1.0	3. Pharmaceuticals	-1.4
4. Transport	-0.9	4. Tobacco	-1.4
5. Investment Trusts	-0.8	5. Oil Exploration	-1.3

Water stocks in demand

COMPANIES REPORT

By Joel Kibazo and Martin Brice

Utilities investors favoured water stocks yesterday, helping shares in the sector move strongly ahead.

United Utilities was a feature after the company and Canada's Northern Telecom announced a joint venture to market their Digital Power-Line communications technology worldwide. A United Utilities statement said the technology allows high-speed internet access and other data transfer such as multimedia, on-line banking and shopping and entertainment. Shares in the UK group rose 26 to 881p in trade of 3.4m.

Kevin Lapwood at Charterhouse Tilney said: "It was evident from the presentation [yesterday] that Northern Telecom is very positive on prospects for the technology. But United Utilities appears to be more cautious in the short term."

As dealers waited for publication of the government's green paper on the regulated utilities (which came towards the end of the session), there was also a feeling that several water stocks had underperformed the market recently and were "looking cheap".

These included Severn Trent, which gained 28 to £10.28, and Hyder, 15 higher at 977p.

Thames Water, which held a briefing for analysts on Tuesday, gained 12 to 972p. Brokers at the meeting indicated that both the group's international and regulated businesses were trading well. Dresdner Kleinwort Benson was said to be positive on Anglian Water. The shares rose 24 to 930p.

The market appreciated the return to profits at retailer House of Fraser, which unveiled pre-tax profits for 1997 of £28.3m compared with losses of £38.4m.

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the previous year, in line with analysts' expectations.

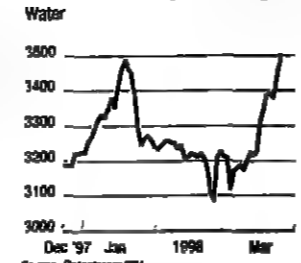
The shares, which have fallen sharply since the beginning of the year following disappointing Christmas trading figures, rose 14 1/2 or 9.32 per cent to 170p yesterday on volume of 2.9m. Analysts expect profits this year to be around the £35m mark.

Speculation that a strong trading statement from bid target Argos could put pressure on predator Great Universal Stores to raise its £1.6bn (or 57p a share) hostile bid for the UK retailer held the rounds in the market yesterday.

Dealers were cheered by Argos's announcement that sales for the 12 weeks to March 21 were up 11.5 per cent overall and 4.8 per cent on a like-for-like basis.

Talk in the market suggested GUS may have to increase its bid to about 63p a share to win control of Argos. GUS shares eased 2 to 777p.

Best and worst performing sectors



Boots improved 1 1/4 to 832p on reports that Dresdner Kleinwort Benson had reiterated its "buy" recommendation on the stock. The retail team at the broker were reported to have said the stock looked attractive given its defensive qualities at a time when the UK economy was expected to slow.

Markus and Spencer, which yesterday announced changes in responsibilities among its directors, gained 10 1/2 to 619p.

Profit-taking left Williams the worst performer in the FTSE 100, off 24 1/2 at 408p.

Engineering group Lynwood International fell 9 1/2 to 285p after NatWest Markets advised investors to "reduce" holdings.

In a note to clients, the broker said: "Short-term trading is under pressure in

Constructors firm

Construction-related stocks confirmed strength in the UK housing and building market as Barratt Developments achieved one of the best performances in the FTSE 250. The stock rose 13 to 319p following strong results that prompted "buy" comments from brokers.

The 254.1m interim pre-tax figure exceeded most forecasts and led to some upgrades, taking full-year forecasts to about £30m-£35m.

The company also said reservations were the highest for a decade and the housing market was stabilising, with the improvement spreading out from the south-east.

London, the fledgling housebuilder, rose 13 to 199p on the back of double pre-tax profits.

Elsewhere in construction-related stocks there was a two-way pull in Tarmac as the stock firm to 119p in brisk trade of 4.8m.

BLP, the wood and veneer group, rose 14 to 194p after good results.

Siebe confirmed what some traders have been tell-

ing clients about fears of the fallout from Asia resulting in engineering stocks being oversold in the run-up to the results season. The company announced £170m of new contracts and made a bullish trading statement saying it was still achieving growth in Asia. The shares rose 17p before closing up 6 on the day at £13.15.

One of the best performances in the Footsie came from Railtrack after it announced higher-than-expected growth forecasts in passenger demand and freight volumes over the next 10 years. Railtrack's shares rose 4 1/2 to £10.39p, bursting back through the £10 barrier not surpassed since December.

The statement that the company was ahead of spending plans it had agreed with the rail regulator was also seen as going some way towards easing regulatory problems.

Fears of increased regulation took their toll on the stock in the run-up to the election of the Labour government last year, but as investor fears eased the shares recovered. Yesterday's announcement was welcomed because of the transparency of Railtrack's investment plans and for its prediction that passenger rail demand would rise 15 per cent within 10 years.

Shares in media group Carlton Communications slipped 25 or 5.15 per cent to 465p after NatWest Securities were said to have downgraded the stock from a "hold" to a "reduce" rating.

Profit-taking was blamed for the decline in Ladbrokes Group, which fell 16 to 342p.

Shire Pharmaceuticals Group jumped 4 1/2 to 406p after it said it had completed a global offering of 21m shares at 543p.

Lack of further takeover news at Savoy left the hotel group's "A" shares 135 off at £16.55.

FUTURES AND OPTIONS

FTSE 100 INDEX FUTURES (LIVE) £10 per full index point

	Open	Settle	Change	High	Low	Est. vol.	Open int.
Mar	6065.0	6116.0	+4.0	6065.0	6025.0	0	14975
Apr						0	235

FTSE 250 INDEX FUTURES (LIVE) £10 per full index point

	Open	Settle	Change	High	Low	Est. vol.	Open int.
Mar	5570.0	5570.0	-4.0	5570.0	5570.0	25	644

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Mar	6065.0	6116.0	+4.0	6065.0	6025.0	0	14975
Apr						0	235

FTSE 250 INDEX OPTION (LIVE) £10 per full index point

	Open	Settle	Change	High	Low	Est. vol.	Open int.
Mar	5570.0	5570.0	-4.0	5570.0	5570.0	25	644

FTSE 100 INDEX OPTION (LIVE) £10 per full index point

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FTSE 100 INDEX OPTION (LIVE) £10 per full index point

WORLD STOCK MARKETS

Highs & Lows shown on a 52 week basis

[illegible]

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[illegible]

Emerging markets:

Order terms

[illegible]

NEW YORK STOCK EXCHANGE PRICES

4 pm close March 25

A		B		C		D		E		F		G		H		I		J		K		L		M		N		O		P		Q		R		S		T		U		V		W		X		Y		Z	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50		
51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100		
101	102	103	104	105	106	107	108	109	110	111	112	113	114	115	116	117	118	119	120	121	122	123	124	125	126	127	128	129	130	131	132	133	134	135	136	137	138	139	140	141	142	143	144	145	146	147	148	149	150		
151	152	153	154	155	156	157	158	159	160	161	162	163	164	165	166	167	168	169	170	171	172	173	174	175	176	177	178	179	180	181	182	183	184	185	186	187	188	189	190	191	192	193	194	195	196	197	198	199	200		
201	202	203	204	205	206	207	208	209	210	211	212	213	214	215	216	217	218	219	220	221	222	223	224	225	226	227	228	229	230	231	232	233	234	235	236	237	238	239	240	241	242	243	244	245	246	247	248	249	250		
251	252	253	254	255	256	257	258	259	260	261	262	263	264	265	266	267	268	269	270	271	272	273	274	275	276	277	278	279	280	281	282	283	284	285	286	287	288	289	290	291	292	293	294	295	296	297	298	299	300		
301	302	303	304	305	306	307	308	309	310	311	312	313	314	315	316	317	318	319	320	321	322	323	324	325	326	327	328	329	330	331	332	333	334	335	336	337	338	339	340	341	342	343	344	345	346	347	348	349	350		
351	352	353	354	355	356	357	358	359	360	361	362	363	364	365	366	367	368	369	370	371	372	373	374	375	376	377	378	379	380	381	382	383	384	385	386	387	388	389	390	391	392	393	394	395	396	397	398	399	400		
401	402	403	404	405	406	407	408	409	410	411	412	413	414	415	416	417	418	419	420	421	422	423	424	425	426	427	428	429	430	431	432	433	434	435	436	437	438	439	440	441	442	443	444	445	446	447	448	449	450		
451	452	453	454	455	456	457	458	459	460	461	462	463	464	465	466	467	468	469	470	471	472	473	474	475	476	477	478	479	480	481	482	483	484	485	486	487	488	489	490	491	492	493	494	495	496	497	498	499	500		
501	502	503	504	505	506	507	508	509	510	511	512	513	514	515	516	517	518	519	520	521	522	523	524	525	526	527	528	529	530	531	532	533	534	535	536	537	538	539	540	541	542	543	544	545	546	547	548	549	550		
551	552	553	554	555	556	557	558	559	560	561	562	563	564	565	566	567	568	569	570	571	572	573	574	575	576	577	578	579	580	581	582	583	584	585	586	587	588	589	590	591	592	593	594	595	596	597	598	599	600		
601	602	603	604	605	606	607	608	609	610	611	612	613	614	615	616	617	618	619	620	621	622	623	624	625	626	627	628	629	630	631	632	633	634	635	636	637	638	639	640	641	642	643	644	645	646	647	648	649	650		
651	652	653	654	655	656	657	658	659	660	661	662	663	664	665	666	667	668	669	670	671	672	673	674	675	676	677	678	679	680	681	682	683	684	685	686	687	688	689	690	691	692	693	694	695	696	697	698	699	700		
701	702	703	704	705	706	707	708	709	710	711	712	713	714	715	716	717	718	719	720	721	722	723	724	725	726	727	728	729	730	731	732	733	734	735	736	737	738	739	740	741	742	743	744	745	746	747	748	749	750		
751	752	753	754	755	756	757	758	759	760	761	762	763	764	765	766	767	768	769	770	771	772	773	774	775	776	777	778	779	780	781	782	783	784	785	786	787	788	789	790	791	792	793	794	795	796	797	798	799	800		
801	802	803	804	805	806	807	808	809	810	811	812	813	814	815	816	817	818	819	820	821	822	823	824	825	826	827	828	829	830	831	832	833	834	835	836	837	838	839	840	841	842	843	844	845	846	847	848	849	850		
851	852	853	854	855	856	857	858	859	860	861	862	863	864	865	866	867	868	869	870	871	872	873	874	875	876	877	878	879	880	881	882	883	884	885	886	887	888	889	890	891	892	893	894	895	896	897	898	899	900		
901	902	903	904	905	906	907	908	909	910	911	912	913	914	915	916	917	918	919	920	921	922	923	924	925	926	927	928	929	930	931	932	933	934	935	936	937	938	939	940	941	942	943	944	945	946	947	948	949	950		
951	952	953	954	955	956	957	958	959	960	961	962	963	964	965	966	967	968	969	970	971	972	973	974	975	976	977	978	979	980	981	982	983	984	985	986	987	988	989	990	991	992	993	994	995	996	997	998	999	1000		

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0722-130

GLOBAL EQUITY MARKETS

FRANCE									
		1997/98			Stacc completion				
		Mar	24	23	High	Low	High	Low	
24C 48	38147.7	37854.5	3880.13	3819.71	2255.87	3814.71	5514.5		
24C 24's High 38147.7		24C 24's High 38147.7							
Net PAUSE TRADING ACTIVITY									
Volume : 1,216,100.53									
IN ACTIVE STOCKS					IN CURRENT MOVES				
Unbalanced	Stocks traded	Close price	Day's change	Up/Down	Close price	Day's change	Up/Down	Day's change	Up/Down
France Par 1	2,168,255	204.5	+17	Up	Market Effect	152	+48	+17.3	
France Tel 1	2,000,413	329	+4.5	Up	Opting (Cn)	459	+39	+67.9	
France 24 1	1,251,000	108.5	+1	Up	Planned	105	+67	+1.0	
France 24 2	1,215,842	104.1	+2	Up	Market Effect	67	+6.7	+6.7	
France 24 3	1,150,044	703	-1	Down	Planned				
France 24 4	1,133,758	103	+2	Up	Market Effect	76.1	+6.7	+1.1	
France 24 5	1,072,829	327	+18	Up	Planned	35.1	-4	-8	
France 24 6	1,065,118	102	+2	Up	Market Effect	100	+18	+4	
France 24 7	1,005,009	877	+18	Up	Planned				
France 24 8	922,445	467	+17.5	Up	Market Effect	46	+20	+11	
UK									
		1997/98			Stacc completion				
		Mar	24	23	High	Low	High	Low	
24C 10	5867.8	5867.3	5847.0	5867.8	4556.5	5867.9	5867.8		
24C 24's High 5867.8		24C 24's High 5867.8							
Net LONDON TRADING ACTIVITY									
Volume : 2,000,413.53									
IN ACTIVE STOCKS					IN CURRENT MOVES				
Unbalanced	Stocks traded	Close price	Day's change	Up/Down	Close price	Day's change	Up/Down	Day's change	Up/Down
France Par 1	2,274,826	443	-94	Down	Market Effect	20	+79	+68.3	
France Tel 1	2,007,590	880	-1	Down	Opting (Cn)	139	+3	+28.8	
France 24 1	1,251,000	108.5	+1	Up	Planned	105	+67	+1.0	
France 24 2	1,215,842	104.1	+2	Up	Market Effect	67	+6.7	+6.7	
France 24 3	1,150,044	703	-1	Down	Planned				
France 24 4	1,133,758	103	+2	Up	Market Effect	76.1	+6.7	+1.1	
France 24 5	1,072,829	327	+18	Up	Planned	35.1	-4	-8	
France 24 6	1,065,118	102	+2	Up	Market Effect	100	+18	+4	
France 24 7	1,005,009	877	+18	Up	Planned				
France 24 8	922,445	467	+17.5	Up	Market Effect	46	+20	+11	

Change	High	Low	Est. vol.	Open int.
+288.00	2971.00	2946.00	7,090	14,674
+91.75	2994.50	2980.00	4,571	20,911
+32.8	7490.0	7425.1	4,337	22,971
+452.8	7425.7	7410.0	14	472

Year	Mar	1957/58 High	1957/58 Low	% High to Low	% High to 1956	
1956	769.4	1769.0	1088.0	119.0%	1.1	14.3
1946	830.4	1676.5	1049.9	116.5%	0.8	42.1
1947	747.1	1382.0	1087.0	125.9%	1.1	11.1
1948	844.3	1643.6	1115.8	147.3%	0.7	11.3
1949	1021.1	1511.8	1277.5	118.3%	0.2	17.0
1950	1045.4	1271.5	1073.7	127.6%		
1950-1956 were broadly flat on total volume of 4221 shares						
1957	127.0	194.3	108.0	180.0%	na	na
1958	178.2	308.4	160.0	217.9%	2.4	13.8
1959	162.7	315.2	164.0	177.9%		
1960	100.4	211.0	106.0	179.7%	0.4	14.8
1961	103.0	181.0	100.0	181.0%	1.7	27.8
1962	103.0	181.0	100.0	181.0%	1.7	27.8
1963	113.0	211.0	106.0	171.0%	na	na
1964	107.2	165.0	104.0	161.0%	1.5	25.7
1965	107.2	174.0	104.0	165.0%		
1966	101.0	165.0	104.0	154.0%	1.3	28.7
1967	101.0	165.0	104.0	154.0%	1.3	28.7
at market heavyweight index						
1968	101.0	165.0	104.0	154.0%	1.1	25.8
1969	101.0	165.0	104.0	154.0%	2.4	32.2
1970	101.0	165.0	104.0	154.0%	0.7	25.7
1971	101.0	165.0	104.0	154.0%	0.7	25.7
1972	101.0	165.0	104.0	154.0%	0.7	25.7
1973	101.0	165.0	104.0	154.0%	0.7	25.7
1974	101.0	165.0	104.0	154.0%	0.7	25.7
1975	101.0	165.0	104.0	154.0%	0.7	25.7
1976	101.0	165.0	104.0	154.0%	0.7	25.7
1977	101.0	165.0	104.0	154.0%	0.7	25.7
1978	101.0	165.0	104.0	154.0%	0.7	25.7
1979	101.0	165.0	104.0	154.0%	0.7	25.7
1980	101.0	165.0	104.0	154.0%	0.7	25.7
1981	101.0	165.0	104.0	154.0%	0.7	25.7
1982	101.0	165.0	104.0	154.0%	0.7	25.7
1983	101.0	165.0	104.0	154.0%	0.7	25.7
1984	101.0	165.0	104.0	154.0%	0.7	25.7
1985	101.0	165.0	104.0	154.0%	0.7	25.7
1986	101.0	165.0	104.0	154.0%	0.7	25.7
1987	101.0	165.0	104.0	154.0%	0.7	25.7
1988	101.0	165.0	104.0	154.0%	0.7	25.7
1989	101.0	165.0	104.0	154.0%	0.7	25.7
1990	101.0	165.0	104.0	154.0%	0.7	25.7
1991	101.0	165.0	104.0	154.0%	0.7	25.7
1992	101.0	165.0	104.0	154.0%	0.7	25.7
1993	101.0	165.0	104.0	154.0%	0.7	25.7
1994	101.0	165.0	104.0	154.0%	0.7	25.7
1995	101.0	165.0	104.0	154.0%	0.7	25.7
1996	101.0	165.0	104.0	154.0%	0.7	25.7
1997	101.0	165.0	104.0	154.0%	0.7	25.7
1998	101.0	165.0	104.0	154.0%	0.7	25.7
1999	101.0	165.0	104.0	154.0%	0.7	25.7
2000	101.0	165.0	104.0	154.0%	0.7	25.7
2001	101.0	165.0	104.0	154.0%	0.7	25.7
2002	101.0	165.0	104.0	154.0%	0.7	25.7
2003	101.0	165.0	104.0	154.0%	0.7	25.7
2004	101.0	165.0	104.0	154.0%	0.7	25.7

THE NASDAQ STOCK MARKET

[illegible]

EASDAQ

[illegible]

STOCK MARKETS

Low inflation drives bourses to new peaks

WORLD OVERVIEW

New peaks are being reached in financial markets so often these days that the authors of the Guinness Book of Records must be developing writer's cramp, writes Philip Coggan.

The announcement by the European Union that the expected 11 countries had qualified for a single currency hardly came as a surprise to the market, but did nothing to disturb the bulls.

A batch of European markets reached all-time highs including Amsterdam, Brussels, Copenhagen, Dublin, Frankfurt, Milan, Madrid, Paris and Zurich.

Low inflation has been one of the factors helping equity markets to reach new highs and it has also pushed up bond prices; the yield on the 10-year German bund dipped to a historic low (since records began in the 1960s) yesterday.

With interest rates and bond yields low, equity valuations have also been stretched. The UK market offers its lowest dividend yield since the first world war. And the US market is now more highly priced, relative to profits, than it has ever been.

The historic price-earnings ratio of the S&P 500 has reached 27.8, higher than at market peaks such as 1987 or 1929 and higher than in 1992 when the recession temporarily depressed earnings.

Even counting on earnings growth does not resolve the valuation issue. IBES, the financial information company, also says that the prospective price-earnings ratio on the S&P 500 index is the highest since the second world war.

There have been adjustments made to the previously rosy consensus view of earnings growth in the US. According to IBES, bottom-up forecasts (those made by individual company

analysts) for 1998 earnings were reduced by 1.6 per cent in February, the largest monthly decline for nearly five years.

Even so, at growth of 11.5 per cent, the bottom-up prediction is well ahead of the 7.7 per cent forecast by the top-down strategists. That suggests many earnings disappointments from the US corporate sector in coming months.

Still, if US investors get tired of local companies,

they may turn their attention to Chinese stocks. The chairman of the New York Stock Exchange said yesterday he expected a rapid rise in the number of Chinese companies listing on the US market; his remarks, made on a visit to the Shanghai Stock Exchange, followed an announcement from Yan Zhou Coal Mining that it was opting for a dual listing in New York and Hong Kong.

London market, Page 30

EMERGING MARKET FOCUS

Good buying on the bad days

Investors in Singapore have become tired in recent weeks of waiting for a clear indication of how Indonesia will deal with its economic predicament. Instead, they have once again begun trading on domestic factors, such as interest rate cuts and what they might mean for the property sector.

It is not that investors no longer fear a spillover from the economic crisis and subsequent social unrest in their southern neighbour. Rather, as Daragh Maher, economist at ING Barings Securities in Singapore, puts it, investors are increasingly differentiating between the south-east Asian nations.

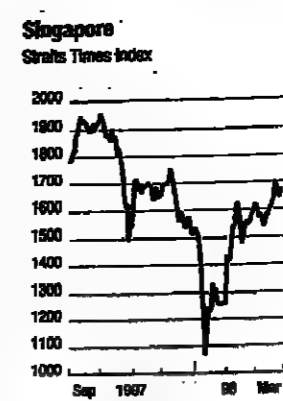
For the growing number of investors who believe two of the three countries most affected by the Asian crisis - Thailand and South Korea - are stabilising, it is time to move back into the region while share prices are still cheap and Singapore is viewed as the safest place to put money.

The currency and stock market have held up better than most because Singapore's economy is well managed and structurally sound. Corporates and banks, meanwhile, have made provisions for troubles to come, and authorities have continued to make the city-state attractive by liberalising the economy.

There is no doubt Singapore's growth will slow with the regional downturn as many of its industries are interlinked with those in neighbouring countries. Indeed, the authorities are projecting 2.5 per cent to 4.5 per cent growth this year, down sharply from 7.8 per cent last year.

But analysts believe smart economic policies and sound corporate governance will see most Singaporean companies through the next few difficult years.

"Corporates generally are stuffed full of cash, the government is stuffed full of



Source: DataStream

cash, so there's no question of survival," says Hugh Young, managing director of Aberdeen Asset Management Asia in Singapore. "All the big boys here are still making money."

He predicts that Singapore's equity market will move in coming months on short-term issues. That likelihood became clear last week when DBS Bank cut its prime lending rate. Investors took it as a sign that interest rates would start falling, which would encourage property purchases. Accordingly, they piled into property stocks, pushing the SES properties index up 10 per cent and helping the benchmark Straits Times Industrials index higher.

Before that, investors had started moving into property stocks on news that competitive pricing of condominiums was bolstering sales. Other trading opportunities, analysts say, will come with future adjustments in rates, further mergers among the banks, announcements of additional liberalisation in the financial sector and, eventually, when the direction that Indonesia is heading in becomes clear.

Mr Young's advice for the next few months: "Buy the good companies on bad days."

Sheila McNulty

Tech sector leads US shares higher

AMERICAS

Strong demand for technology shares, sparked by bullish comments from software leader Microsoft, set a firm start to US equities, writes John Labate in New York.

By early afternoon the Dow Jones Industrial Average was hitting record highs, gaining 33.13 to 8,937.57. The broader Standard & Poor's 500 index rose 5.13 to 1,110.76. The sharpest gains came from tech shares which sent the Nasdaq composite index up 21.33 or 1.2 per cent to 1,833.77.

Microsoft said late on Tuesday that it expected its forthcoming quarterly earnings to top analysts' estimates. This helped soften disappointing comments on the same day by 3Com, a leader in networking computer components, of lower than expected quarterly sales and earnings.

Microsoft's shares climbed 44%, or more than 5 per cent, to \$85.4, while 3Com lost \$1 to \$86.4. 3Com's disappointment was not only well contained in the computer sector, but also did not send investors running from the networking sector.

Cisco Systems gained \$1.16 to \$99.74 and other computer sectors also rose sharply, with Dell Computer up 39% or more than 4 per cent to \$68.7.

Among Dow components, IBM and Hewlett-Packard

were among the morning's sharpest risers. IBM gained 24% to \$105.4, while HP rose \$1.8 to \$64.8.

Xerox surged \$4.4 or more than 4 per cent to \$101.4 after rumours spread about possible job cuts. Also helping shares was a raised price target by Salomon Smith Barney.

Banking shares were mostly higher despite a dull start to the US Treasury market. The Philadelphia Stock Exchange's banking index gained 2.65 to 861.28. The price of the 30-year long bond, meanwhile, slipped 1/8 to 102 1/8, sending the yield up to 6.922 per cent.

TORONTO continued to test record highs at midday, spurred by merger mania in the telecommunications sector. The TSE-300 composite index was 38.27 higher in midday trade at 7,589.50.

Telus and BCE led the rise in telecoms as the sector moved up on confirmation that AT&T Canada Long Distance Services was in merger talks with Telus.

Telus rose \$2.80 to \$45.35 and the Montreal-based BCE rose \$1.85 to \$39.20. BCE owns Bell Canada, the country's largest telephone company.

The rest of the sector was sent higher by speculation that the Telus talks could lead to a restructuring of the long-standing Stentor alliance of Canadian telephone companies.

helped sentiment. The Bovespa index, which has advanced 12 per cent since the start of this month, rose 23 to 11,528.

SAO PAULO gained as higher markets in Asia

Mexico City slips back

MEXICO CITY edged lower as the government's announcement of a budget cut prompted light profit-taking.

The IPC index fell 10.7 to 4,998.98 as the government announced that low oil prices had forced a 90n peso cut in its budget.

SAO PAULO gained as higher markets in Asia

Banks and insurers hit peak

SOUTH AFRICA

Bank and insurance stocks sped to record highs as investors continued to favour a rash of mergers and consolidations in the financial sector. The financial index jumped 296.0 or 2.2 per

cent to 18,979.4 while industrials, up 86.8 to 8,624.4, helped the overall index to rise 84.0 to 7,314.3.

Gold, however, tumbled 26.6 or 3.5 per cent to 718.5 as the bullion price fell below the psychologically important \$300 an ounce.

Tokyo rally hit by tax doubts

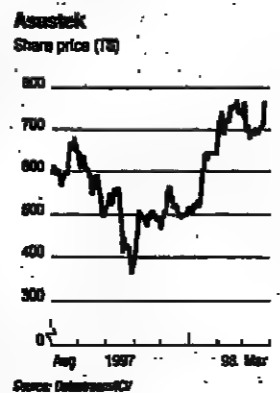
ASIA PACIFIC

Tokyo stocks closed slightly higher yesterday after an early rally petered out, writes Gillian Tan in Tokyo.

The Nikkei 225 closed at 16,558.34, up 0.31 per cent, after moving between 16,574.53 and 16,938.66 in heavy trading. Total volume was 490m shares, slightly higher than Tuesday's 476m.

The swings on the TSE partly reflected continued uncertainty about the direction of the government's economic policies. Until last week, most traders thought the government would unveil income tax cuts later this week. However, on Monday those hopes were apparently dashed when senior figures from the ruling Liberal Democratic party ruled out tax cuts because of the government's commitment to fiscal consolidation.

However, Koichi Kato, LDP secretary-general, said yesterday he might call for the government to delay consolidation. This helped push the Nikkei 2 per cent higher in the morning but the market fell back after another LDP figure said he did not wish to see a delay.



Source: DataStream

The Nikkei's rise was also curbed by the fact that many large institutional investors are selling ahead of the year-end close on March 31. Wednesday was virtually the last day companies could unwind cross-shareholdings for the 1997 fiscal year.

The broad-based Topix index also fell 0.19 per cent to 1,236.71. The Nikkei 300 fell 0.23 per cent to 242.7. The Osaka stock exchange fell 26.23 to 16,570.50.

Gainers led decliners 620 to 489 with 177 issues unchanged. The best sectors were communications, min-

Paris shatters 3,800 barrier

EUROPE

Shares in PARIS broke through the 3,800 barrier to close at the session's high. The CAC 40 index ended 80.17 higher at a record 3,818.71, up nearly 4 per cent in two days.

Peugeot stormed to the top of the performance charts, climbing 11.97 or 10 per cent to FF1,070 after promising operating profits of at least FF5bn this year, against FF3bn in 1997.

This helped punch the sector sharply ahead with Michelin up FF18.60 to FF256. The latter also gained from talk that Rhône-Poulenc's plans for a capital

impact on earnings per share in 1998.

VW gave up DM36 to DM1,396 after the group's annual news conference.

ZURICH remained aloof as a strong financial sector helped to offset losses in market heavyweight Roche.

The SMI index turned back a day's high of 7,481.7 but was still able to extend its run of record setting closes, up 64.7 to 7,472.1.

Roche, which on Tuesday reported an accounting loss of SF27m, moved ahead in pre-bourse trade but came under pressure during the regular session to close SF740 lower at SF716,000.

Analysts said that the results met expectations although restructuring charges were higher than expected.

J.P. Morgan, which repeated its buy recommendation for Roche, raised its 1999 earnings forecasts and set an end-1999 share price target of SF18,725, up from SF17,400.

Novartis, rose SF748 to SF7,700, profiting from shifting out of Roche.

Nestlé, the food and beverages company, rose SF767 to SF7,825 ahead of the release of 1997 results today. Zuercher Kantonalbank forecast 1997 group profit of SF4.1bn.

Financials UBS and its merger partner, SBC, rose on the back of a Goldman Sachs' recommendation. UBS gained SF780 to SF7,438 and SBC was SF712 higher at SF533.

Knomi surged SF7400 to SF7,600 in the wake of Tuesday's news of a 36 per cent rise in 1997 net income.

AMSTERDAM continued to push higher amid heavy, options trading where the bulls were firmly in command with call positions outstripping puts by more than three to one.

Royal Dutch, where investors' faith in the rally for oil prices looked to be facing a severe test, and Agnion were weak features, but there were solid gains elsewhere

ing, insurers, pulp and paper, and textiles. Major losers were brokerages, banks and electric power.

Matsumoto Electric Industrial jumped ¥100 to ¥2,000 after the company said on Tuesday it would buy back up to ¥100bn of its shares.

Long Term Credit Bank fell ¥19 to ¥265, Industrial Bank of Japan ¥30 to ¥242, Sumitomo Bank ¥30 to ¥1,280, and Bank of Tokyo Mitsubishi ¥30 to ¥1,640.

TAIPEI shot higher as investors piled into electronics shares. The weighted index ended 233.90 or 2.7 per cent higher at 8,940.75 after a 5 per cent advance for the electronics sector in the wake of strong overnight gains for US tech shares.

Taiwan Semiconductor rose T\$6 to T\$182 and Asustek, a leading maker of motherboards, surged by the daily 7 per cent limit to T\$765.

HONG KONG raced ahead, boosted by higher-than-expected prices at Tuesday's government land auction, and on hopes that the territory would follow China's example by cutting prime rates tomorrow.

China's rate cut, along with Beijing's decision to

FTSE Actuaries Share Indices

March 25						
Index & Regional	Index	Day's %	Change	Yield	Vol	Total
				gross		retail
FTSE Europe500	1217.38	+0.78	+9.17	1.80	4.54	1222.30
FTSE Europe100	2608.10	+0.67	+18.59	-	-	-
FTSE Europe300 Regions						
EMEA UK	1118.32	+0.04	+0.48	2.78	10.42	1228.30
EMEA EU-UK	1229.58	+1.18	+14.16	1.42	1.20	1238.12
EMEA EU-NonUK	1212.36	+1.26	+16.22	1.38	1.74	1218.57
EMEA EU-Finland	1224.85	+0.34	+4.12	2.10	0.87	1244.88
FTSE Europe500 Economic Groups						
Resources	1038.12	-1.01	-10.24	2.80	3.62	1056.50
Consumer Goods	1129.58	+1.29	+14.70	1.75	1.35	1145.88
Consumer Services	1187.51	+0.87	+10.61	1.58	2.27	1194.69
Services	1168.55	+0.72	+8.41	1.87	4.07	1182.15
Utilities	1165.51	+0.58	+7.84	3.24	1.84	1184.85
Healthcare	1177.27	+1.41	+17.25	1.70	1.20	1194.52

MIDDLE EAST & N AFRICA PRIVATISATION

There has been a gulf between claims of commitment and actual achievement. Roula Khalaf reports

The pressures for change mount

Privatisation is the talk of the Middle East and North Africa. From Riyadh to Casablanca governments are claiming commitment to privatisation and to reducing state control over the economy, and vowing that the next decade will see a fledgling private sector thrive.

Although the record so far is patchy, with many countries paying only lip service to privatisation while others which had warmly embraced it are now taking a pause, over the coming years governments in the region will have little choice but to give the private sector a larger role in the state-dominated economies.

The oil-rich Gulf countries are again facing the challenge of lower oil prices and are being pressured to relieve the burden on budgetary spending by reducing the state's extensive welfare role. The non-oil countries of the "emerging Middle East" are being called on to compete in a global economy and meet the productivity requirements of association agreements with the European Union, which can only be achieved by gradually turning over production and services to the private sector.

As Mohamed el-Erian, European head of emerging markets at Salomon Smith Barney, argues, events on the world economic stage provide the region with a unique opportunity.

Against the background of turmoil in Asian markets many economies in the region look good, with strong macro-economic

fundamentals, limited trade and financial linkage with Asia, sound banking systems and high foreign exchange reserves," he says. "You couldn't wish for better conditions to accelerate privatisation, allow for the transfer of technology and bring in foreign capital."

The region's requirements and the challenges facing countries are monumental. Development of infrastructure alone has been estimated to cost up to \$350bn over the next decade, and most governments now admit that the private sector will have to shoulder a large part of the cost.

If virtually every government has privatisation on the agenda it is in part because the region desperately needs to generate growth sufficient to create jobs for a rapidly growing population, more than half of which is under 25. Unemployment rates are a huge concern, reaching as high as 30 per cent in Jordan and 28 per cent in Algeria, often hitting young graduates the hardest and fuelling anxieties of social unrest.

One main reason why the region has lagged behind others - per capita income deteriorated in the period 1985 to 1995 - is that the state continues to dominate the economy. With state resources dwindling, both public and private investment has been stifled. Private investment for the region as a whole has stagnated at about 10 per cent of GDP since 1980, while public investment has declined from 15 per cent of GDP to under 10 per cent.

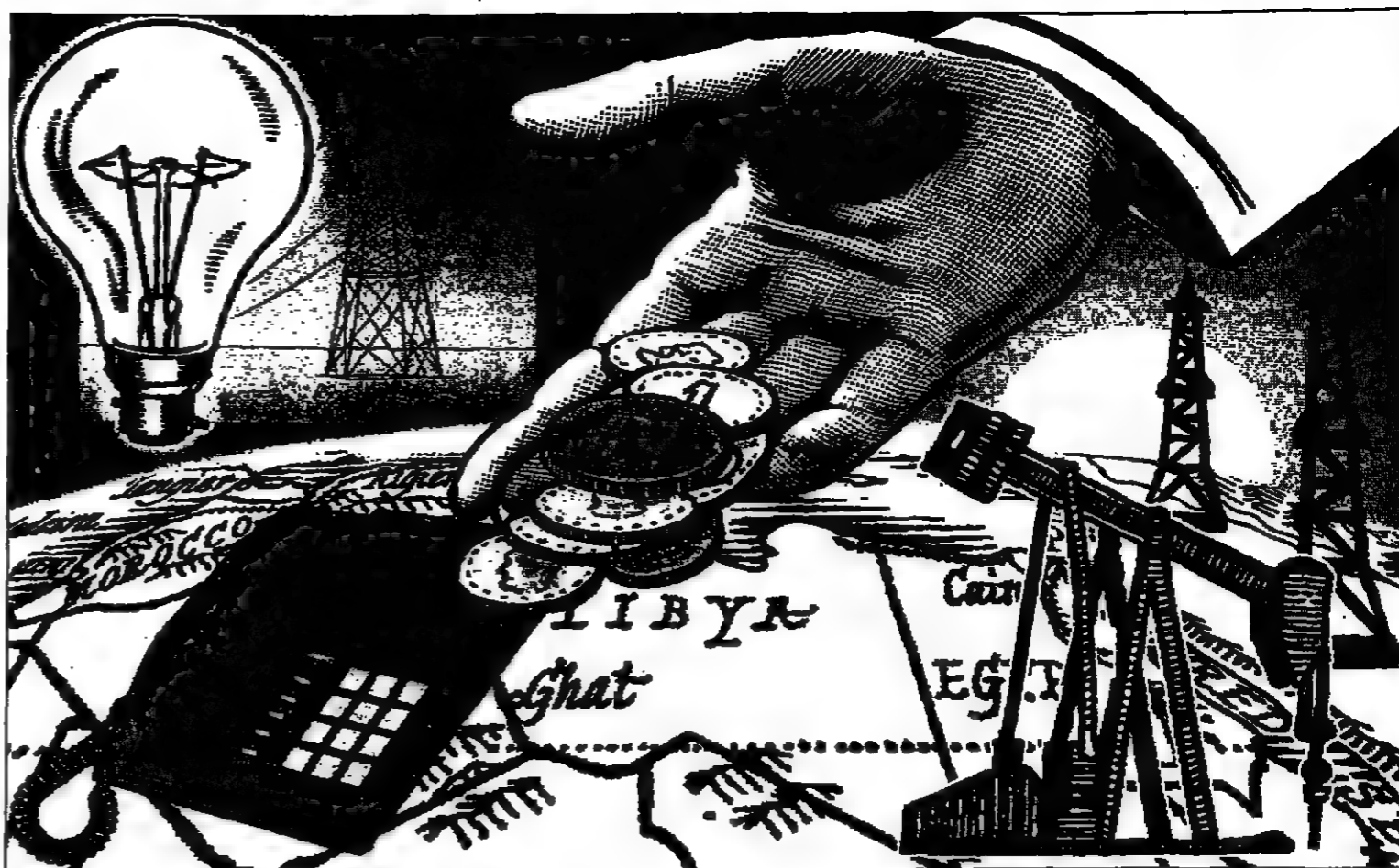
"The government's dominant role in the economy has tended to undermine productive private sector activities rather than support them," says a 1997 IMF report.

There have, however, been improvements during the last two years.

In spite of political uncertainty and the breakdown in the Middle East peace process, real per capita GDP growth increased by 2.4 per cent in 1996 and 1.4 per cent last year. Capital flows to the region - which have averaged 0.5 to 0.7 per cent of GDP - have increased most notably in Egypt, Morocco and Jordan. Private investment has also overtaken public investment in the last few years, and companies from the region have been able to tap international markets for finance.

The improvements since 1996 are partly due to external factors, such as favourable oil prices. But, as the IMF has noted, the results - particularly in the non-oil economies - were a response to successes in moving away from "years of inward-looking, public sector-led development strategies, particularly in the non-oil economies".

While higher oil prices allowed Gulf economies to straighten their finances, economic reforms initiated over the last 10 years have lifted the growth potential of Egypt, Jordan, Morocco and Tunisia. But with macro-economic adjustment now firmly in place, the attention is turning to structural reforms, in which privatisation features



prominently.

Not surprisingly, most successful efforts at privatisation in the region have been in the non-oil economies.

Egypt's privatisation, which took off in 1996, has captured the attention of international investors. As in Morocco, which launched its privatisation programme three years earlier, the benefits of privatisation quickly became apparent, with trading on the domestic stock exchanges soaring and the emergence of a domestic investors' market.

In both cases privatisation also sent the right signals to foreign investors and was the driving force behind an increase in foreign investment. Privatised companies, such as Egypt's Suez Cement and Morocco's Banque Marocaine pour le Commerce

Extérieur, have successfully tapped international markets for finance.

Meanwhile, government concerns over loss of employment have been met through specific restrictions set in Morocco and agreements with labour unions in Egypt. Yet in both these countries the initial euphoria over privatisation has given way to more sombre analysis. The Egyptian government has been criticised for maintaining a larger-than-warranted share in companies it has sold. In Morocco the programme has become mired in a bureaucratic tangle which has highlighted the need to revisit privatisation legislation.

In Israel, meanwhile, the Likud government kept its promise to make privatisation the main pillar of economic policy but privatisation is believed to have stifled competition and led

to greater concentration of the economic power.

Throughout the region economists are warning that privatising a largely state-dominated banking industry has fallen behind and should become a priority to give a nascent private sector the chance to develop.

In Gulf economies, dominated by oil, governments are viewed as the providers of employment - in Kuwait more than 90 per cent of the workforce is employed in the public sector - and the distributors of the country's wealth through huge subsidies. This is why privatising requires a radical change in mindset and in the nature of governance.

Nemat Shafik, the World Bank director for private sector development and finance for the Middle East and North Africa, argues that for these economies the

privatisation challenge is not targeted at public enterprises as much as infrastructure since many state-owned companies are run by private management and are generally not a drain on the budget.

Indeed, throughout the region, governments are giving unequivocal signals of a willingness to begin turning over development of infrastructure and telecommunications to the private sector.

The first privatisation of state-run telecommunications monopolies is expected to come from Jordan this year, with Morocco, Kuwait and Oman in progress. Private mobile telephone licences are also being awarded in several countries.

New privately-financed power projects have been started or are about to be launched in Oman, Egypt,

Morocco and Tunisia. Plans appear to be advanced in Abu Dhabi, where demand for electricity is rising 10 per cent to 15 per cent a year. The emirate has set up a privatisation committee for the water and electricity sectors, which is expected to bring in private capital along with public shareholding over the next decade.

The extent of governments' commitment to infrastructure privatisation, however - especially in Gulf countries - will depend on the willingness to reduce lavish subsidies and allow the market to determine the price of utilities.

"Countries need to face up to the subsidies issue," says Ms Shafik. "Bringing in the private sector is a good move, but to get the full benefit of the privatisation, you have to gradually phase out the subsidies."

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2 MIDDLE EAST & NORTH AFRICA PRIVATISATION

INFRASTRUCTURE • By Mark Huband

Investment held back by neglect

The private sector is starting to take over water, energy and road projects in the region

Neglect and under-investment have taken their toll on infrastructure across the Middle East. Bad roads, poor telephone systems, and inadequate or non-existent sewerage and water supplies have disrupted living standards and deterred investment in the region.

Unable to provide the funds required to reverse the trend, governments have been forced to seek private sector finance and control of main infrastructure projects. In 1997 the World Bank estimated infrastructure investment requirements at \$300bn to \$350bn over the next 10 years. Given fiscal austerity in much of the region, it believes as much as \$50bn of projects will need to be financed by the private sector.

The most serious inefficiencies in the Middle East are found in the water, energy and transportation sectors. According to the World Bank, 45m people in the region do not have access to safe drinking water and only 20 per cent of urban wastewater is treated.

Nemat Shafik, the World Bank director for private sector development and finance for the Middle East and North Africa, says most projects are likely to be in telecommunications and power. "It is very easy to get the private sector to finance these projects but difficult for them to do rural water supply because they can't charge consumers prices they need to make a profit."

Heavy state subsidies have deterred private investment in water management

schemes, leaving governments to finance improvements to services, often with foreign aid grants. Even so, a \$141m private sector disqualifier project is under way in southern Jordan on a build-operate-transfer (BOT) basis. Morocco has also signed a management contract with Lyonnaise des Eaux de France to distribute water in Casablanca.

Energy projects offer more security than water schemes for private sector investors and operators. Nationwide power grids allow negotiations over supply and price to be simplified.

By 2002 private sector operators are expected to be generating 6,000MW across the region. Region-wide demand for energy is expected to grow annually by about 6 per cent by 2006, a factor likely to open opportunities for private sector construction and operating companies.

Among the first private sector deals in the region was the 1994 BOT thermal power facility at Al Manah in Oman, which has already started operations. The \$200m project was partly financed by the International Finance Corporation and will be followed by a second BOT 200MW plant at Salalah.

In September 1997 Tunisia awarded a foreign consortium led by Community Energy Alternatives of the US a \$300m contract to build and operate a 300MW combined-cycle gas turbine station at Rades, south of Tunis. The project was the first of its kind in the country, and marked a departure from the government's cautious attitude towards privatisation.

Morocco is now looking for investors to develop other private power schemes, following the signing last year



Transport is one of the most serious inefficiencies in the Middle East

Photo: Reuters

of a \$1.5bn deal for the expansion and operation of power plants at Jorf Lasfar, 230km south of Rabat. The new Tabaddart Energy Company (Tec) will build a 470MW gas-fired power station near the northern city of Tangier. However, Tec will be operated as a joint venture in which the state electricity company will hold a 51 per cent stake.

Sidi Krier, Egypt's first venture into private sector BOT power generation, has been applauded by both the companies who put in tenders, as well as by the architects of the government's privatisation programme. The \$300m project to generate 850MW is one of two power generation plants under construction to help raise energy output from the current 14,800MW to 43,000MW by 2018.

Like Egypt, Jordan is only just embarking on BOT power projects, with results of the first bid for a private sector 300MW power station expected this month.

Egypt and Jordan have followed the experience of the United Arab Emirates in

seeking private sector involvement in energy generation. Abu Dhabi, which has already pursued a privatisation programme, is inviting bids for an electricity and water co-generation plant. The BOT Taweeleh A2 project will generate up to 580MW of electricity and 50m gallons of water a day. An initial government-held majority stake will be reduced through share issues, though electricity transmission will remain in government hands.

Such projects, even in cash-rich emirates, reflect a realisation that the private sector's role cannot be avoided. To reach a planned 6 per cent of economic growth Morocco, for example, must invest \$2.3bn a year in infrastructure - \$800m more than currently. Spreading the cost and exploiting private sector capital and expertise is now an accepted way of pursuing growth targets.

While the countries of the region are attracting investors in large projects, the hope that such modernisation will bring foreign direct

investment in industrial sectors is the main goal. Beyond improving utilities, investment in transport infrastructure is viewed as essential if foreign direct investment is to rise.

Private sector transport projects are planned across the region, with Egypt considering a 900-km BOT motorway linking Alexandria with Aswan. In Jordan a build-operate-transfer light rail service between Amman and Zerga is to be established. An industrial port in Agaba is also being built with a 50 per cent private sector participation. Morocco has invited bids for a \$300m BOT trans-shipment port in Tangier, as well as offering a management contract for the existing port.

Egypt's port and airport facilities are likely to be expanded in the coming years. A free port south of Suez is planned as part of a privately-operated industrial zone to be established on the Red Sea. Along the same coast, the contract for a new BOT airport at Marsa Alam has been awarded, as has one for an airport at El-Alamein.

Private sector involvement in road networks and motorways is complicated by the difficulty in predicting revenues. But in Lebanon, where an ambitious \$600m reconstruction project is under way, the government has realised that it will have to shift more projects to the private sector than originally envisioned. Consequently, the Beirut-Damascus highway and the beltway around Beirut will be financed and operated by the private sector.

ISRAEL • by Judy Dempsey

Doubts exist over benefit of sales

Sell-offs have concentrated economic power into the hands of a few families

When Benjamin Netanyahu was elected prime minister of Israel in May 1996 he made privatisation the main plank of his economic policy. He pledged to sell off the banks as well as the government's stakes in telecommunications and other sectors of the economy. He believed privatisation would usher in an era of much-needed competition.

Nearly 22 months into the Likud-led government, Mr Netanyahu has stuck to his promise. During 1997 the government earned more than \$1.5bn from privatisation receipts - higher than expected - for use in reducing Israel's foreign debt. But the question is whether privatisation has created a wider public ownership and more competition, or has it, as some economists claim, led to a greater concentration of the economy.

Daniel Mamon, a sociologist specialising in business groups at the Hebrew University, wrote: "The state privatisation policy is in direct contrast to its aim of reducing the level of concentration. It has, in fact, led to the opposite: raising the high level of concentration."

A review of how the government reduced its holdings in banks and other companies appears to confirm Mr Mamon's view. During 1997 the government sold substantial stakes in four banks - Israel Discount, Leumi, Mizrahi and Hapoalim. Discount was a public offering, as was Leumi, but Mizrahi and Hapoalim were sold to some of Israel's largest, dominant families in the economy.

Mizrahi, for example, was sold to the Ofer and Wertheim families while Hapoalim was sold to the Danker family and Ted Arison, the US-Israeli billionaire with substantial financial interests in Israel. There are now suggestions that the government's majority stake in Leumi may be sold through a private placement instead of a public offering.

Apart from the banks, the government sold its stake in Israel Chemicals, a company with interests in potash and magnesium. But it, too, was a private sale. Majority control was passed to the Elsenberg family which owns The Israel Corporation and whose interests span ship-

ping, real estate, chemicals and financial services.

Yozma, a government-owned capital risk company set up to invest in high-risk industries, was sold privately to the Ofer brothers, and a private placement was arranged enabling Naphtha, a petroleum company, to acquire a majority stake.

Koor Industries and Clal Israel, industrial conglomerates in which Hapoalim still holds stakes, have also come under the control of two family groups. The Recanat family acquired a controlling stake in Clal when Hapoalim, by law, had to divest itself of a percentage of its non-banking holdings. This enabled the Recanats to merge their IDB Discount investment conglomerate with Clal, creating one of the biggest mergers in Israel.

Control of Koor also passed to a family group four months ago when the Bronfman family of Canada acquired a stake through its

ship which in turn would have increased liquidity on the Tel Aviv Stock Exchange.

The impact of the government's privatisation policy shows two things. First, the economic influence of a few families has become stronger; secondly, foreign investors - with the exception of Bezeq and Leumi - were not involved in any of the sales.

"There is no doubt that the Israeli economy is heavily concentrated in the hands of a few families. Share ownership is not widespread here," says Nahum Bigger, finance professor at Haifa University.

Other economists offer a more critical assessment. Officials at the anti-trust authority, for example, say privatisation, contrary to the government's intentions, has not led to greater competition - one of the government's aims - since the few families who dominate the economy have interests in



Benjamin Netanyahu pledges on privatisation

Photo: Reuters

investment arm, Claridge Israel.

The only company that made a secondary public offering - as well as a private foreign placement - was Bezeq, the telecommunications company. Merrill Lynch, the US investment bank, acquired a 12.37 per cent stake last year. The government recently arranged a public offering, selling a further 9 per cent of shares and warrants that could reduce its stake in Bezeq to just over 54 per cent.

The government defends its privatisation policy, arguing that it wants to reduce state interference in the economy. "That was its priority as it tries to make the transition from a socialist-led economy to a more market-oriented one," explained a finance ministry official.

But economists, while welcoming a commitment to privatisation, believe an opportunity might have been lost to create wider share owner-

ship through cross-holding structures.

Officials at the anti-trust authority argue that these structures and inter-relationships inhibit competition since the holding companies, all with close ties, do not compete with each other. Even within the holding companies, subsidiaries in the past have rarely gone outside the group even if services offered outside the holding company are at a lower price.

Dismantling those cross-holdings is one of the aims of the anti-trust authority, headed by David Tadmor, an advocate of opening up the Israeli economy to more competition. "It is clear that privatisation has not created wide ownership. It has concentrated ownership," he said recently. "It is the anti-trust authority's responsibility, at the very least, to assure that conditions for competition between the conglomerates will exist."

MOROCCO • by Roula Khalaf

Stuck in the slow lane

Bureaucracy and prices have been significant stumbling blocks in programme

Abderrahmane Saadi, until recently Morocco's minister of privatisation, is the first to admit that the country's once-vigorous privatisation programme has stalled and now requires an urgent jump-start.

This task is now in the hands of the first political government to emerge in Morocco in decades. Led by a prime minister from the left-leaning Union Socialiste des Forces Populaires, the new government is expected to continue Morocco's commitment to divesting of state assets, although with more attention paid to the social consequences.

This, Mr Saadi says, should not necessarily indicate a further delay in privatisation and could be done by simply earmarking privatisation proceeds to social spending, including the retraining of workers to limit pressure on unemployment, already reaching 16 per cent in urban areas.

Morocco was among the first countries in the region to tackle privatisation seriously. This earned it the attention of foreign investors and fuelled activity on the Casablanca Stock Exchange. But the programme, launched in 1993 with a privatisation list of 112 companies that was initially hoped would be completed within two years, has led to the sale of only 52 concerns so far, 11 of them partially through public offerings on the Casablanca Stock Exchange. The sale of companies has netted

the treasury some Dh14.5bn.

Privatisation faced several stumbling blocks, including the ineptitude of Morocco's huge and byzantine bureaucracy, the source of much frustration in the country's efforts to liberalise its economy.

"I warned two years ago that, without reforms, privatisation risks being stifled," says Mr Saadi. "To give a new breath to the process we need to change procedures and broaden the methods of privatisation."

Among the measures recommended is to avoid placing companies on the list of privatisation until they are ready and about to be sold. One of the main problems faced by Mr Saadi is that 15 of the 112 companies earmarked for privatisation had to be liquidated as uncertainty over several years led to a loss of incentive among management and workers.

The procedure by which companies are privatised should also be streamlined, says Mr Saadi. Some privatisations have failed or stalled because a minimum price set by an independent committee could not be met by the market.

A price was set for the Banque Nationale pour le Développement Economique in 1995. Four years later the ministry of privatisation is still trying to sell it. Today, the problem faced by BNDE is that the ministry of finance maintains the bank's buyers should assume the state guarantees that BNDE had given clients.

Having started the privatisation programme with the most attractive enterprises, analysts say that only a few of the 112 companies originally listed that can be privatised. These include BNDE and Banque Centrale Popu-

laire, which must undergo a change in its legal status before it is privatised.

Analysts believe that the formation of a new government will end the long period of political uncertainty that has prevailed in Morocco for more than a year while elections were taking place. The political process delayed decision-making on issues such as changes in the procedures.

"The state monopolies will eventually fall one by one," predicts Mr Saadi. "The fact that privatisation slowed down means that the private sector in the economy may have slightly lost ground, but Morocco will continue to work to re-establish the balance."

Companies will be added to the privatisation list and will eventually include Royal Air Maroc, the national airline, the tobacco monopoly and one day, even phosphate companies. But the project already whetting foreign investors' appetite for the planned privatisation of the telecommunications sector, which will give the programme a welcome jolt.

A second GSM mobile phone licence will be handed to private companies this year, in a market which has been growing at more than 70 per cent a year and now reaches more than 49,000 subscribers. But the telecommunications privatisation law passed last year also allows for the introduction of private capital in Morocco's telecommunications provider, Itissalat al-Maghrib.

Anas Alami, analyst at Casablanca's Upline Securities, expects Itissalat's privatisation to begin with the introduction of a 20 per cent stake on the Casablanca bourse, after which the government will search for a

"hard core" foreign investor, but will at least temporarily retain control of the company.

Infrastructure development is another main area where private investors are being called upon to play a significant role. World Bank officials say Morocco has been at the forefront of the regional trend towards private sector participation in infrastructure projects, and Rabat officials say that involving the private sector in infrastructure is no longer a matter of choice.

"To reach 6 per cent sustainable growth we need to invest about \$2.3bn a year in infrastructure. This is about \$800m more than what we now spend, and it is the size of all of our foreign investment in one year," says one senior official. "This is how difficult the challenge is."

Morocco has already signed a management contract with France's Lyonnaise des Eaux for water distribution in the financial capital of Casablanca, a deal Moroccan authorities say they will repeat in other cities.

It has also signed a \$1.5bn deal with Zurich-based ABB and the US's CMS Energy for the building of a 700MW coal-fired plant next to the existing 800MW plant at Jorf Lasfar, some 230km south of Rabat. Another \$54m build/operate/transfer wind power project is to be built in Tetouan by a private consortium led by France's EDF.

However, Morocco's efforts to lure foreign companies to construct a 120km Casablanca-EI Jadida motorway fell through when bidders asked for guarantees that the government proved unable to provide. Rabat is now looking for local investors to take up the challenge.

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EGYPT • by Mark Huband

Choosy investors play wait and see

State still holds strong sway in most of the part-privatised companies

Just a year after Egyptian stocks became some of the hottest property in the Middle East the fanfare announcing Egypt's emergence as an investor's dream has been muted by a game of wait and see.

The privatisation programme which led the investment drive of 1997 saw stock market capitalisation soar by \$6bn in one year to reach the current \$20.2bn. Fundamentally the process was less a move towards rescinding state control of the economy than allowing the state to profit from investor interest while boosting the role of the capital market as a source of private sector funds.

The government has earned \$2.7bn from privatisation. This income, largely from minority share issues, has allowed \$561m to be spent on restructuring the public sector in advance of further issues. However, the impact of the issues has fallen far short of marking the relinquishment by government of a significant role in the economy, which has become a deterrent to private sector investors who are ready to buy large or majority stakes.

The government responds to this criticism by highlighting the need to retain investor interest over time by maintaining its ability to release further tranches of shares. Its strategy of stealth was partially vindicated by the failure of the alternatives. To back it up it points to the banking collapse of south-east Asia. Egypt also drew direct lessons from Mexico's banking collapse in 1995, concluding that investment levels should not create unserviceable leverage.

"What I blame the government for is that it keeps a big stick over the successful companies that have been part-privatised," says Saad Sallam, chairman of the Olympic Group. The group's holding company, OGFI, recently bought a majority stake in Ideal, Egypt's leading public sector manufacturer of domestic appliances. "The government imposes restrictions on privatised companies for political reasons," he said. OGFI was originally told it could not dispose of the land occupied by Ideal's four production sites. The group intends to bring all production to one site outside Cairo and must now negotiate the fate of the land despite being the owner. "If the government

wants me to have the courage to get into a company and turn it around, they should give me everything - give me a free hand. The impact of restrictions is that it slows privatisation," Mr Sallam said.

The effect of the brakes being kept on the pace of privatisation is clear. By the end of last month the state had sold shares in 34 companies. However, it remained the largest shareholder in 29 of the 34 companies in which more than half the shares had been sold. Of eight companies, in which less than half the shares had been sold, it retained an average 70 per cent of shares.

The government has announced plans to privatise 34 companies in 1998 at a rate of four to six a month. However, the excitement of foreign and domestic investors on the stock exchange has come to be dominated by a combination of both caution and growing discernment.

While 1997 saw stocks being snapped up, 1998 has experienced a slowdown in trade while investors await the most attractive sales at the expense of other privatisations.

The best recent example of this was the February issue of 30 per cent of shares in Egypt's Mobile Phone Company cellular phone system, which was subscribed 50 times over and saw an eventual allocation of 1.7 per cent, in some cases amounting to a mere 25 shares. A second example was EgyptAlum, a fully-subscribed issue in which a mere 10 per cent of the company was sold to the public. Both these issues initially revived stock market trade, which then slowed while the next attractive issue was awaited.

A growing tendency among investors to wait for the most promising issues has been a key factor in determining the pace of the privatisation programme, while turning trading trends into a series of crests and troughs.

The government does not want to deter would-be investors by disappointing those who fail to secure a meaningful proportion of the shares applied for. Equally, it is under strong pressure from critics of privatisation not to sell state assets too cheaply, a charge often made despite an increasingly careful pricing procedure having been instituted.

The attitude of investors has become dominated by a tendency to await sales of shares in unlisted private sector companies, which control 45 per cent of the economy. By far, the most

attractive enterprises expected to be offered on the stock exchange are family-owned private sector companies, who appear increasingly prepared to rescind some of their traditional control in return for the gains in capitalisation offered by share issues.

The role of the private sector as anchor investors has been critical to privatisation. So far only nine public sector companies have been sold to Egyptian private sector anchor investors. As competition for investor interest from the private sector begins to diminish interest in minor public sector shares issues, the search for anchor investors will become more critical.

"But when the government wants to privatise, they don't reach the right people," said Saad Sallam, who had to approach the government with his plans to buy Ideal. "They wait for people to come to them, which is a sign of a major management problem."

CASE STUDY SHUAIBA PROJECT

Power running out of steam

The Shuaiba power station project near Jeddah, in Saudi Arabia's western province, is a classic example of the government's ambivalence towards privatisation.

The \$2bn steam power plant, to be built for Saudi Consolidated Electric Company for the Western Region (Seco-West), has been touted since 1996 as the first independent power facility in the kingdom, using build-own-operate (BOO) financing.

But it now appears that the government will have to do the job itself. The state is increasingly reluctant to carry the cost, and still more reluctant to accept the implications of allowing the private sector to do the same job profitably and more efficiently.

According to industry and electricity minister, Hashem Yamani, the tender for Shuaiba comprised four options.

The BOO option would leave responsibility for financing the plant during a 20-year period to a private consortium, which would own and operate Shuaiba, recovering its costs from power generation revenues.

The second option was for a lump-sum turnkey approach by which the government would cash-finance each stage of the

construction and, like all other power plants, own and operate it after completion.

The third and fourth options were variations of the second: turnkey contracts on the basis of separate eight and 10-year extended financing.

The BOO option initially drew bids from five groups combining heavyweight companies from both Saudi Arabia and overseas. But by last November Seco-West's director-general, Bakr Khoshaim, was saying a turnkey approach would have to be adopted as there was "no time" to wait.

There is some justification for this argument. Power consumption is rising 10 per cent a year throughout the country, and building the 1,750MW power station at Shuaiba is urgently necessary.

But other reasons underlay official dislike of privatising Shuaiba.

Construction on a BOO basis would mean the owner running Shuaiba profitably as a prelude to making Seco-West commercially viable. That in turn would mean a wholesale restructuring not only of Seco-West, but the entire power sector, including drafting - and the government approving - a fresh

legal and regulatory framework. Critics accuse the government of dragging its feet in the face of these daunting options.

First, privatisation would mean the gradual end of state subsidies, which cost nearly \$1bn a year in the power sector alone, a figure which officials say the state cannot afford when budgets are in deficit. Abolishing subsidies, however, is a politically delicate subject.

Second, running Shuaiba as a private commercial venture would mean allowing foreigners into a strategically sensitive area.

But the option of keeping things the way they are may be even less attractive.

In these days of low oil prices and revenues and monetary reserves lower still, the government does not relish the prospect of having to spend, according to Mr Yamani, \$116.5bn in the next 25 years on power generation, excluding capital costs for transmission and distribution.

For Shuaiba alone, the government would want to borrow to finance construction. But bankers are not keen to lend to Seco-West, whose \$360m loss in the year to June 30 was only the latest in a series, without a sovereign guarantee from the

government. That, says Mr Yamani, will not be forthcoming.

Bankers this month were sceptical that industry re-structuring will be done quickly or thoroughly enough to satisfy Seco-West or the banks. However, even if Shuaiba were to remain a state project and Seco-West a state entity, there are ways to make it a more attractive credit risk.

Separate electricity generating plants could be set up under the Seco umbrella to operate profitably. Distribution and transmission companies would remain as they are, relying on state subsidies.

If Mr Yamani had his way, "corporatisation" of the entire power sector "would be done tomorrow," he insisted this month. He issued an unprecedented directive in August authorising foreign investors to participate in power projects. "But corporatisation is still being discussed by the cabinet," he says. That is a delicate way of saying, according to industry observers, that the cabinet has vetoed the whole idea, as the state is not yet reconciled to the concept of "privatisation".

Robin Allen

GULF COUNTRIES • by Mark Huband

Control stays with the ruling families

Rigid political control tends to encourage 'participation' by private sector

The Gulf states have attracted private sector investment, encouraged stock market trade and allowed greater foreign access to the economies of the region, but not in a way which has resulted in meaningful privatisation. Control remains with ruling families, whose preferred phrase is "private sector participation".

Privatisation implies a thriving private sector. In Saudi Arabia, the state has in essence been privatised and control lies in the hands of the ruling elite.

The rigidity of political control and the immense wealth of the elite have determined the investment patterns which will shape the future of the private sector.

Half of the \$900bn assets held by the 350,000 wealthiest Gulf nationals - who represent 2 per cent of the region's population - is held abroad. This is three times more than the combined market capitalisation of the Middle East's top 50 listed companies.

Without a lead from those who control the oil wealth

and political power of the region, it is unlikely that any political decisions will be made which will shake up investment patterns. Private sector investment is therefore unlikely to take off unless state ownership is reduced through privatisation.

The downside of state control has slowly dawned on the region's decision-makers. When the loss-making state-owned Saudi Arabian Airlines failed to find \$4.5bn for new aircraft it had to approach international capital markets, which demanded a sovereign guarantee. This from a country whose stock market capitalisation stands at \$58bn.

Privatisation of utilities would require a widespread overhaul of pricing, billing and service provision before foreign investors would consider seeking a share.

Scale is everything. Saudi Arabia is reckoned by its senior officials to need \$116.5bn over 23 years to build new power stations. It will find such ambitions hard to realise without adopting private sector build-operate-transfer (BOT) schemes, which will chip away at state control.

It has been left to the smaller states to spearhead moves towards attracting a real private sector role through privatisation. Even so, this process has been extremely limited.

Qatar has now awarded 60 per cent of the contract to build an aluminium smelter to Norak Hydro. This ground-breaking deal marks the first time any Gulf state has allowed a foreign joint-venture partner, in this case with the state-owned Qatar General Petroleum Corporation, to hold a majority stake.

Despite acceptance elsewhere - notably in Oman and Bahrain - of foreign majority stakeholding, theory has yet to become reality. Oman has secured substantial project finance for state-led investments and infrastructure projects, as well as being home to the

region's sole private sector power plant, the 90MW al-Manah power station. But the government withdrew the privatisation of the Salalah Water and Sewage Company because of difficulties over agreeing an accurate sale price - the value of the company being skewed by subsidies and widespread non-payment of bills.

Bahrain has changed its law to allow 100 per cent foreign ownership of companies. It has also drawn up a favourable tax regime and currency regulations to attract investors. But privatisation has yet to follow, with the future sale of Bahrain Telecom, communications

Company (Batelec) a long way off.

Abu Dhabi stands out for having instituted a series of initial public offerings, despite not having a stock exchange on which to trade them. This year eight IPOs are planned in sectors ranging from banking, gas distribution and satellite television.

However, the absence of a stock exchange - the only Gulf Co-operation Council state without such a facility - has deterred private sector share issues within the UAE states, and led to unauthorised trading in shares in markets renowned for insider dealing and price manipulation.

Kuwait's commitment to

the privatisation of state

utilities has emerged from the process of disposing of state assets acquired during the early 1980s. The government is expected to establish a new authority to launch moves towards privatisation in the telecommunications sector following the expected ratification of a new investment law next month.

The Kuwait government has so far sold shares in 16 companies and now has plans to offer 50 per cent of Kuwait Airlines to the public. It will sell its shares in a total seven companies during 1998, ranging from a cattle-rearing operation to banking and cement manufacture.

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4 JAPAN'S FINANCIAL REVOLUTION

PROFILE *Kantoh Securities*

Speculating at the sharp end of the securities market

Gambling is officially frowned upon by the Japanese authorities, so people invest in the stock market instead. But will the arrival of deregulation spell the demise of the numerous discount brokerage houses that fulfil the nation's innate desire to gamble?

At the smoke-filled offices of Kantoh Securities in central Tokyo one recent morning, speculation was in full swing as a hard core of the firm's 2,000 customers congregated around flickering screens. Kantoh is one of the many firms that rely almost exclusively on commission income for survival, and its executives are predicting some tough times ahead when fixed commissions are abolished next year.

"It is at this end of the securities market, with virtually no exposure at the moment to foreign competition, that resistance to Japan's Big Bang is strongest, although most are not in any position to influence its timing or outcome."

"We are forecasting a drop in commission income of 40 per cent, so we are worried and concerned," says Tadatoshi Kondo, president of Kantoh. "If our commission income falls by that much, it will cost us ¥800m over three years."

The 30 or so people in the office that morning are among about 200 people - Mr Kondo describes them as "more or less semi-professional investors" - who are responsible for the bulk of the firm's commission income. Kantoh had total revenues of ¥143m in the year to March 1997, of which ¥87m came from commissions.

"These customers are free to choose what they

want to buy and sell. For a small business like ours, it is important to maintain this type of business," he adds.

Across Tokyo, however, there is growing speculation about what the fate of these and other small brokerages will be once commissions are liberalised. There is one small ray of hope for them - in the US and the UK after their versions of Big Bang, commissions on small retail transactions actually rose after deregulation. But even if that happens, it may not be enough to make up for the loss of business to larger, more professional and perhaps safer firms that are expected to be the trend as deregulation takes hold.

That is why some firms, including Kantoh, are looking to merge with smaller rivals to gain market share and a firmer foothold in the new market. Earlier this year Kantoh and Dofina Securities, a discount house in Osaka, announced that they were to merge, in what may be the first of many such transactions in the coming months. Mr Kondo describes the merger as a strategy for surviving Big Bang, a strategy that will have to be embraced by other discount brokers after years of losses caused by the stock market slump.

"This merger is a sincere hope that we will continue to survive after Big Bang, but I am more worried than confident," he says. Nevertheless, Mr Kondo is counting on the patriotism of the Japanese, and especially of his type of investor, to shun the blandishments of foreign competitors and remain loyal to firms such as Kantoh.

Vincent Boland

THE BROKERS • by Vincent Boland

Difficult days for securities houses

The brokerages depend heavily on commissions which are due to be abolished

After the collapse of Yamaichi Securities at the end of last year, the lesser-known firm of Kokusai Securities was propelled into the spotlight by taking its place as Japan's fourth-biggest securities company, behind Nomura, Daiwa and Nikko. It is a position that makes Koichi Kane, Kokusai's executive managing director, a little uneasy. "We never wanted to be in the top four, but we are now. Quite frankly, market share has never been our aim, but profitability is. In that sense we are somewhat unique," says Mr Kane.

Because these are difficult days for Japan's faded securities houses - a moribund stock market, the imminent ending of fixed commissions, intense competition, and the ever-present threat of scandal - the league table has never been more fluid. And not all the surprises the industry is facing are likely to be as pleasant as Kokusai's sudden elevation to the top rank.

Japan's brokerages are heavily dependent for their income on fixed commis-

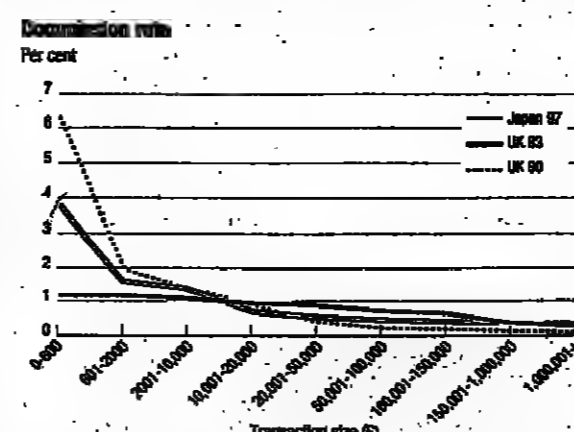
sions, which are to be abolished with deregulation of the country's financial markets. How they will cope when that finally happens next year is the question they are all now asking.

Survival is assured for some, such as Kokusai, and Kosei Securities, an aggressively lean firm in Osaka. For others, a painful readjustment, if not a painful exit, is in prospect.

"Japanese securities companies have to introduce measures to increase revenues," says Yasuo Kanazaki, chairman emeritus of the Nikko Research Centre. "They will have to switch to fee income and away from commission income. That will put the emphasis on total asset volume rather than on portfolio turnover."

At the same time, they will have to control and cut costs and expand the range of products they offer the customer. Doing all of these things together, and successfully, will be a tall order for many firms.

To be fair, some are already working on post-Big Bang strategies. Alliances are emerging between local and foreign firms to develop and sell new products, especially mutual funds and "wrap" accounts, to capture a bigger share of Japan's enormous personal savings



Source: Japanese Ministry of Finance, Tokyo Stock Exchange, Deutsche Morgan Grenfell

market. This is valued at ¥1,230,000m, a number that slips easily from every Japanese banker's tongue, and the vast bulk of it is in cash deposits or post office savings schemes.

As well as looking to broaden their product ranges, some, such as Kokusai, are focusing on costs. Mr Kane says his firm began cutting its cost base in 1990, when the company's profits were at a peak and the bubble stock market had yet to suffer its disastrous attack of vertigo. It also, unusually, got rid of job titles and introduced bonus remuneration for staff linked to performance.

Today, Kokusai claims a 25 per cent share of the mar-

ket for sales of investment trusts managed by western investment banks such as Goldman Sachs and Morgan Stanley. Its target market is rich individuals seeking more professional management of their wealth.

It also has a niche position in initial public offerings and bond trading, and along with Kosei and Nomura, which owns 33 per cent of Kokusai, is much less dependent on income from commission than other firms.

The result, according to a report in February by Deutsche Morgan Grenfell, is that Kokusai "is one of the few major brokers outside the Big Four with a decent earnings record." Firms of a similar size, such as New Japan,

Kankaku and Wako, have not been so fortunate.

Others are now seeking to copy Kokusai's formula. Daiwa Securities unveiled its own Big Bang strategy at the end of last year that includes reorganising management, increased investment in technology, developing a global product line including investment banking, introducing the bonus system of rewarding staff, and allowing staff over 50 to retire earlier than the statutory age of 60 if they wish.

The strategy "is all based on the understanding that we will not survive intensified competition without it," says Shinichi Yamamura, Daiwa managing director and board member.

However, executives at securities firms generally sound lukewarm in discussing the possibility of being taken over. One growls: "We have nothing to learn from our Japanese competitors."

Instead, as outlined by Goro Tsumaki, chairman of Kosei Securities, firms need to focus more on what their clients need and develop products that can be sold.

"We should think in global terms in developing new products," he says. "Just having an investment market of ¥1,200 million million is not enough in itself. We have to add value."

THE BANKS • by Gillian Tett

Rivalry to replace cosy collaboration

The competitive battle seems to be starting. Painful choices will now have to be made

A few months ago, Sanwa Bank, one of Japan's largest, took an innovative step. With Big Bang looming, it would offer customers a service no other Japanese bank had done - telephone banking.

What happened next took Sanwa by surprise. Sumitomo, another huge bank, promptly started telephone banking as well - precisely one day before Sanwa. "We wanted to show we could be first," says a Sumitomo executive cheerfully.

The tale might seem trivial. But it points to a wider - and potentially momentous - shift in Japan's banking world.

Until now Japan's banks have operated through cosy collaboration, not rivalry. But Big Bang promises to create a newly competitive climate. As the banks scramble to respond, the uncertainty now is whether this competition will leave the banks looking stronger than

before - or whether the attempt to make Tokyo a globally competitive financial centre will take place at the expense of the domestic banks.

Drastic change is certainly needed because, with or without Big Bang, the fact is that Japan's banking system is currently in a mess. The basic problem is that during the past five decades the government has developed the financial sector around a national goal of directing savings to manufacturers, rather than building profitable banks. Banks, for example, have maintained close links with customers through cross-shareholdings.

Competition has been reduced by a so-called "conveyor" system in which strong banks were expected to support the weak. Businesses were strictly segregated: Japan's three long-term credit banks provided long-term lending; the 10 "city" banks focused on retail business; the seven trust banks offered asset management services; and a mass of regional banks serviced local clients.

This pattern worked when Japan's economy was grow-

ing rapidly. But it is now in crisis. The bursting of the 1990s bubble has left the sector weighed down with huge problem loans, currently put at some ¥77,000m. The falling stock market has slashed the value of the banks' equity portfolios, which the banks count towards their capital.

Meanwhile - and most crucially - the banks' business franchises are vanishing. Japanese companies no longer rely exclusively on the banks for funding: since 1993, companies have increased their reliance on capital markets from 29 per cent of funding to 42 per cent.

Spreads on corporate lending have slumped. And though some banks have wanted to diversify, they have been prevented by industry segregation. Most banks have been increasing, not shrinking, their loans to recent years. Consequently, David Atkinson of Goldman Sachs, calculates that even if the Japanese banks cut all costs, their ROE would be a shockingly low 19 per cent, compared with 30 per cent and 68 per cent in the US and UK.

Can Big Bang change this? Some reforms may help. Tearing down industry barriers, for example, will allow banks to enter new businesses, such as asset management. Introducing holding companies could allow more efficient management. And irrespective of actual deregulation, the debate about Big Bang is ushering in a new willingness to flout the "conveyor" system.

Meanwhile, the banks are scrambling to show investors that they have new strategies, spurred on by a plunge in their share prices last year.

Nippon Credit Bank, for example, has decided that it wants to target smaller companies. Yasuda Trust is withdrawing from overseas business. The Industrial Bank of Japan is trying to turn itself into an investment distributor of mutual funds.

This is encouraging: until recently the banks rarely talked about specialist business niches or shareholders. But it may not, in itself, solve the banking sector's woes. For if the banks are to become competitive by west-

ern standards, they must address other issues.

One is their bad loans. All are now pledging to make huge write-offs in the 1997 fiscal year that is forecast to leave the top 10 banks collectively recording ¥3,608bn worth of losses in fiscal 1997. But the banks are still proving painfully slow to actually realise the loss by selling the land they hold.

Another is their management style. This has traditionally been very hierarchical, with pay set by age and staff rotated frequently between jobs. But globally competitive banks require highly motivated specialists.

Some Japanese banks are now reforming their personnel system along these lines but none has yet made serious job cuts. Meanwhile, many are losing good staff to western competitors who offer better pay.

But the biggest issue of all is the sheer number of banks. Margins are currently low because too many banks are chasing the same business. There are hints that this is changing; a few regional banks have recently closed or merged. Last autumn, Japan saw some-

thing hitherto considered inconceivable - one of its top 20 banks, Hokkaido Tokai-Mitsubishi, collapsed.

But reform, as so often in Japan, is painfully slow. The government now insists that no other big bank will be allowed to fail. Indeed, this month it agreed to pump some ¥1,800bn into the banks - both weak and strong - to increase their capital base. Government officials argue that if capacity is taken out of the system, it should be done through outright failures, but through mergers and the creation of holding companies instead.

This might work - over time. But time is not something the banking sector has.

If Japan can accept a wave of consolidation, then the strongest banks could flourish. If it cannot, then the country's banks will stagnate - and Japan will see a half-hearted Big Bang. Either way, Sanwa and Sumitomo's rivalry over telephone banking is one sign the competitive battle is starting. The country now has some painful choices to make.

LIFE INSURANCE COMPANIES • by Bethan Hutton in Tokyo

Yet another challenge

The threats and opportunities offered by deregulation are only one concern

The Big Bang for Japan's insurance industry may actually have been heard a year ago, when Nissan Mutual, a life insurer, collapsed.

The Hashimoto Big Bang is just another step in a series of challenges which have faced the industry over the past decade. Foreign pressure, particularly from the US, has already led to the opening of Japan's insurance market to foreign firms, as well as starting to break down barriers between competitors in different sectors domestically.

Those moves have been gradual. But the sudden collapse of Nissan Mutual, a medium-sized life company, in April last year, dramatically rocked complacency about Japan's insurance industry among consumers and in financial circles.

It also illustrated how Japanese life insurers have slipped from being international financial giants to struggling companies overburdened with bad loans and with capital bases weakened by years of paying out more in guaranteed returns to policyholders than they were making on their own investments. International ratings agencies have recently issued pessimistic reports on the life sector: several companies were given highly marginal ratings.

Nissan Mutual's downfall hit unsuspecting policyholders, who had assumed

that because the company was regulated by the finance ministry, their money was safe. In fact most will lose a large proportion of their money because there was no guarantee scheme for insurance policies in place.

This realisation shocked Japanese consumers into willing more closely to their insurance arrangements. New business is down at all life companies, and policy cancellations have been running at record rates, with the particularly large scale at the smaller, weaker insurers. American Life Insurance, one of the longest established foreign insurers in Japan, now emphasises in its advertising that it is AAA rated.

At the same time as other regulations are being relaxed, the government is planning new legislation to help prevent more collapses, and protect consumers if they should happen.

Firstly, the finance ministry will monitor the solvency levels of insurance companies, particularly life insurers, more closely. It became clear after Nissan Mutual failed that the company had been insolvent for months, if not years. The new system will force insurers to disclose information about their financial status to regulators, who can then insist on prompt action to deal with the problem, rather than allowing business to continue as usual.

And in case this early warning system does not prevent further collapses, "policyholder protection corporations" are due to be set up, funded by compulsory contributions from insurers.

They will cover at least 90 per cent of policyholders' funds in the event of an insurer's collapse.

The funds should be up and running by December this year.

Meanwhile, deregulation has already increased opportunities for those companies willing and able to take advantage of them. Life companies are being allowed to move into the non-life sector, and vice versa, while the third sector - areas such as critical illness cover - which has long been the home territory of the foreign insurers, is to be opened up to all comers.

Some domestic companies seem to prefer the status quo, however, and have been unwilling to move aggressively into new markets. Foreigners are not so shy. Some, such as AIG, have been active in Japan for a long time.

One thing the foreign companies bring with them is a more advanced approach to underwriting and policy design. Previously, Japanese insurers had a "one size fits all" approach - there was little differentiation in premiums to take account of varying risks.

Premiums also hardly varied between companies because competition was mainly on the strength and persistence of the sales force, together with the insurer's relationships with other companies. Now, deregulation is making design, innovative policy design and risk-weighted premiums possible, with foreign insurers leading the way.

were the traditional home for a large proportion of Japan's savings, both from individuals, through savings-linked insurance products, and from pension funds, which entrusted their funds to life insurers to manage. That is changing.

With Big Bang, individuals will be given a far greater array of savings products to choose from, including ones in different currencies and investing in new instruments. Poor returns from insurance policies mean that the insurer will be struggling to hold on to much of that business.

The options for pension funds have already been broadened to include foreign investment advisers, and the remaining limitations should soon be lifted. There are already signs that more pension funds, both private and public, are turning to foreign investment managers. Their investment returns are consistently better than Japanese life companies, which have much more conservative investment policies.

One life insurance analyst says that the changes expected under Big Bang will accelerate the general trend towards differentiation in the market, helping the strong companies become stronger, and pushing the weak ones closer to the edge.

But the threats and opportunities offered by deregulation are just one of Japanese insurance companies' current concerns. Their financial state and poor investment returns may be much more significant, at least in the short term, than any loosening of the regula-

PROFILE

Striking record of growth in profits

Not many chairman of Japanese financial companies have reason to look cheerful these days. But Yasuo Takeuchi, chairman of Daiwa Securities, Japan's largest securities house, is an exception. His business has grown fast: annual profit growth has exceeded 12 per cent in five of the past six years, and the company has 2.5m customers. Pre-tax profits have surged from ¥101.8bn in 1995 to ¥131.2bn in 1997.

This success has partly been because, being outside the traditional financial hierarchy, he has avoided many of the problems of the Japanese banks.

The company is not weighed down with huge bad loans. It has been innovative in introducing new services, such as late opening loan dispensers. And whereas banks and brokers hire very few women, 30 per cent of Takeuchi's branch managers are female - which allows the group to attract good skills at a lower price.

With Big Bang looming, the company is now trying to win more mainstream acceptance. Although it was 77 per cent family owned, Mr Takeuchi recently sold about a tenth of his shares and wants to list on the 1998 first section. He is particularly targeting foreign investors.

"Foreign institutions seem to understand our business better," Mr Takeuchi says.

Mr Takeuchi set up the company in the late 1980s, after he noticed that consumers found it hard to obtain short-term loans to a hurry because of the banks' bureaucracy. He set a very different figure from Japanese banks.

he speaks with a directness unusual in Japan, and sports a subtly shaped suit instead of the usual dark attire. Nevertheless, his business has grown fast: annual profit growth has exceeded 12 per cent in five of the past six years, and the company has 2.5m customers. Pre-tax profits have surged from ¥101.8bn in 1995 to ¥131.2bn in 1997.

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Gillian Tett

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JAPAN'S FINANCIAL REVOLUTION

The planned financial reforms could revive Japan's ailing economy. But there are crucial problems still to be resolved. Gillian Tett reports

Big Bang or just a whimper?

Japan is not a country which likes radical revolution. Next week, though, it may start on one. On April 1, the country will officially begin its much-heralded and ambitious programme of so-called "Big Bang" financial deregulation. The question now is whether this will indeed turn out to be a Big Bang that transforms its financial sector - or simply a whimper that disappoints.

The answer matters intensely, not only to Japan but also to the outside world. Japan is the world's second-largest economy and contains a third of the world's savings. But since the collapse of the 1990s bubble, its economy has stagnated. The stock market has more than halved in value and its banking and broking system is weighed down with debts, falling revenues and losses. These are grave problems and they reflect another issue: Japan's financial system is ill suited for a modern economy.

Over the past 50 years, the needs of savers have taken second place to industry's demand for cheap loans. Returns on household financial assets have averaged a mere 2.5 per cent, for example, during the past 15 years. Capital markets are poorly developed. Meanwhile, the financial sector is highly reg-

ulated and uncompetitive.

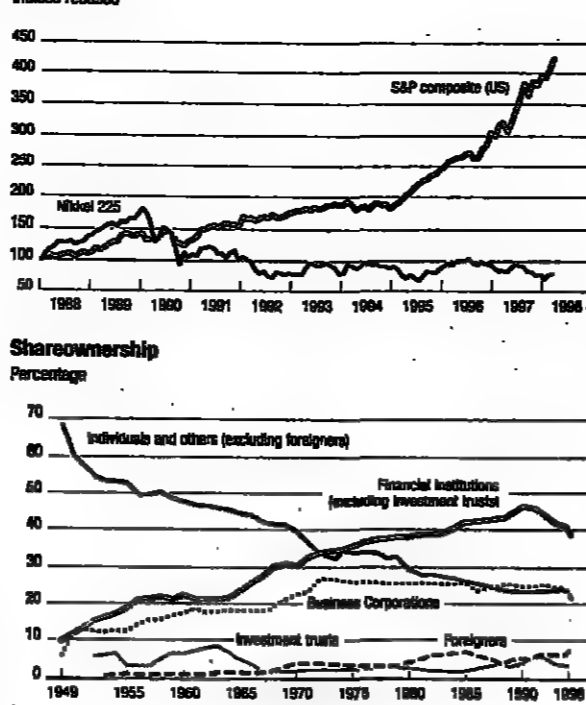
The Japanese government now has pressing motives to change this. The population is ageing and urgently needs better returns on its savings. And Japan's national pride has been dented by a flight of business from Tokyo to other financial centres, such as London and New York.

A third of all trades in Nikkei 225 futures, for example, is currently conducted not in Japan, but Singapore. Similarly, only 57 foreign companies are now listed on the Tokyo Stock Exchange, compared with 290 in New York, 533 in London, 560 in Frankfurt and 157 in Paris. In theory, Big Bang could address these sort of problems; in essence it aims to inject a burst of competition into the hitherto protected financial sector by tearing down industry barriers, financial cartels and obstacles to innovation.

The details of how Big Bang may achieve this are complex but there are three key points to grasp:

● Firstly, the reforms are not actually occurring in a single "bang", but in a staggered manner. April 1, for example, has been cited as the official "start" because on this date two changes occur: foreign exchange controls will be removed, and stock broking commissions will be partially liberalised.

Nikkei 225 Average
Indices rebased



Source: Tokyo Stock Exchange, Reuters Business Data

Such steps have great symbolic value. Similar reforms in the late 1970s and 1980s in the US and UK helped trigger the financial revolutions in New York and London's "Big Bang" in 1986.

Liberalising foreign exchange has a particular importance because it could spur more reform. Removal of foreign exchange controls will make it easier for Japanese companies and investors to use financial services outside Japan. It could thus create a massive capital flight, unless Japan becomes more competitive.

But these changes are only part of the plan: a further wave of reforms will be unveiled between now and 2001. The real impact of Big Bang will not become clear for several years.

● The second point is that the reforms are much broader in scope than the British "Big Bang". London's reforms centred on the liberalisation of stock broking commissions but Japan's version is aimed at changing the way capital is used in the Japanese economy. Con-

sequently, it affects not just the securities sector but also banking, asset management and insurance.

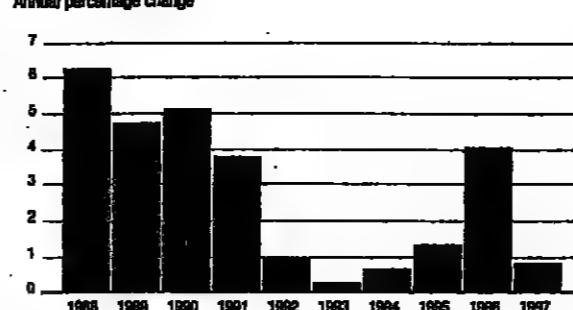
● The third issue is that the "Big Bang" process involves more than the official timetable alone. The debate about change in Japan has itself prompted a shift in cultural attitudes, even before the new laws bite.

Change is being driven not just by "top down" orders, but also "bottom up" market pressure, as companies seek better funding channels and investors demand higher returns on their savings.

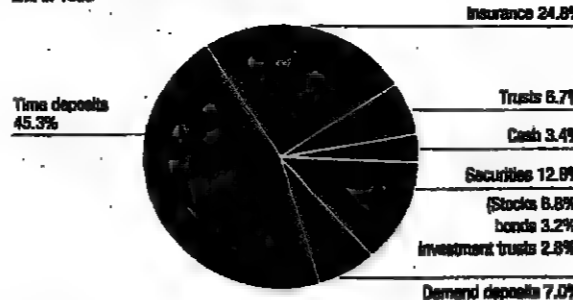
So does this mean that a revolution is now inevitable? Perhaps. But the speed and scale of Big Bang remains uncertain because in spite of all the government's bold pledges about change, the project still faces crucial questions. One is whether Japan will accept the pain that a genuine Big Bang could inflict on the country's banking and broking sector.

The government insists Big Bang is not intended to protect Japanese companies, but to make Japan more

GDP
Annual percentage change



Financial assets of individuals
End of 1995



competitive as a country. But many Japanese still assume the project must benefit banks, brokers and life insurance companies.

Some companies may indeed emerge strengthened from Big Bang but genuine competition could have a devastating impact on weaker companies. For Japan has massive excess capacity in its financial sector. Until it removes this, the strongest groups will not become competitive by world standards.

Consolidation has started. Over the past year several brokers have failed, including Yamaichi, Japan's fourth-largest. One life insurance company, Nissai Mutual, has collapsed. Several regional banks have merged, and Hokkaido Tokai-shoku, one of the top 20 banks, has collapsed.

But the pace of change is mixed. This month the government, for example, announced it would pump ¥1,800bn of public money into 21 banks to help them shore up their capital base. This included strong banks

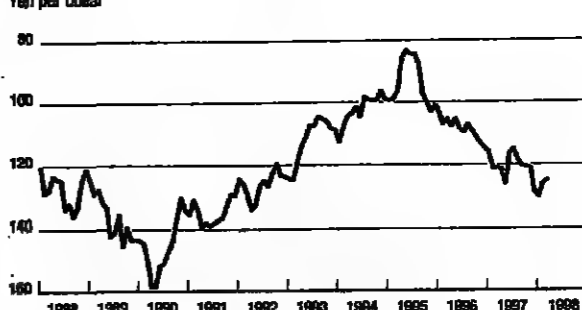
who did not want the money - and weak ones that have an uncertain future. Curbing the protectionist instinct could take a long time.

The second great uncertainty is whether Japan will tolerate a foreign invasion. Big Bang does not include an explicit commitment to greater market access for non-Japanese. But free competition should give them unprecedented business opportunities. And western groups have already been winning a strikingly high market share in sectors such as corporate pension funds and investment banking.

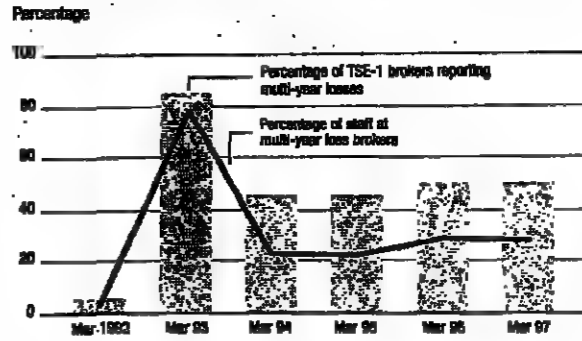
But Japan has a complex attitude to foreigners and alarm is rising about the prospect of Tokyo repeating the experience of London's Big Bang, where outsiders bought British merchant banks and its financial markets are now dominated by non-British groups.

This scenario seems unlikely in Japan. Few foreign banks, after all, have shown enthusiasm for buying debt-laden Japanese banks or brokers. Foreigners

Yen
Yen per dollar



Excess capacity in the securities industry
Percentage



are unlikely to oust Japanese banks in their traditional domestic niches of retail banking and corporate lending. But foreigners could certainly win the prizes in the new - and most lucrative - business niches, such as specialised investment banking products. If this happens too visibly, nationalist instincts might reappear, which in turn could hurt Japan's attempts to attract international business.

The third risk is the regulatory climate. Big Bang will not succeed unless Tokyo can persuade investors that its markets operate in a transparent manner. This has blatantly not been the case in the past, as recent streams of corruption scandals have shown.

The government has now pledged to change this, but if Tokyo cannot create an effective regulatory environment, deregulation could simply accelerate the "hollowing out". And at present the Big Bang reform timetable gives relatively little emphasis to the problem of

regulation. Nor does it tackle one of the biggest problems dogging Japan - a shortage of competent, independent accountants and lawyers.

If Japan can overcome these three risks, then the country may indeed be on the verge of momentous change. Japan's vast pool of savings could partly move out of the banks and into new investment instruments. Some strong Japanese financial companies could emerge from the current mass of mediocre banks, brokers and life insurance companies. Japan could become the world's second-largest asset management and investment banking market for western firms.

But if reform is half-hearted, it could actually exacerbate Japan's financial "hollowing out". And this in turn would further damage the economy.

The world has every reason to hope that what starts today will be a genuine Big Bang - and not a series of painful whimpers. The coming years are crucial ones.

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2 JAPAN'S FINANCIAL REVOLUTION

POLITICS • by Michio Nakamoto in Tokyo

Decision to opt for Big Bang came as a surprise

Bureaucrats and politicians both had good reason for promoting financial reforms

The Japanese leadership has traditionally been sceptical of sweeping changes.

Elite bureaucrats who are charged with policy formation have tended to favour a gradual approach towards reform, while Japanese politicians, for their part, have seldom shown much aptitude for launching bold policy initiatives.

So the decision to set in motion a financial "Big Bang" aimed at opening up the country's highly protected financial industry in one broad swoop, came as something of a surprise.

Was Big Bang a bureaucrat-led initiative designed to breathe new life into Japan's flagging financial industry, or an attempt by

reform-minded politicians to wrest policy formation away from the mandarins? Or did US pressure, which has been responsible for much of the recent deregulation measures implemented in Japan, have a role to play?

"The US has always been involved in the liberalisation of Japan's financial markets," points out Susumu Saito, director of Trilateral Institute, a private think tank.

When Ryutaro Hashimoto, the prime minister, unveiled his plan to launch Big Bang on November 11, 1996, he appeared to be the main driving force behind the decision. After all, Mr Hashimoto had made clear that the pillar of his second term in office would be far-reaching reform of the way Japan works.

But Mr Hashimoto is also known for his close ties to bureaucrats, and former bureaucrats. A loner within his own political party, he

relies for policy advice predominantly on his closest aides whom he plucked from the Ministry of International Trade and Industry (Mitl) and the Ministry of Finance (MoF), both of which he previously headed.

In particular, Atsuo Saka, executive assistant to the prime minister and a former finance ministry bureaucrat, together with a group of like-minded bureaucrats at the MoF, are credited with planning the idea of bold and rapid financial liberalisation in Mr Hashimoto's mind.

Mr Saka, who served as Mr Hashimoto's secretary when he was finance minister, was personally recruited by the prime minister to serve as his aide.

The pro-reform group advising Mr Hashimoto includes Eisuke Sakakibara, vice-minister of finance for international affairs, who is known as "Mr Yen" for his unofficial role as Japan's top financial diplomat.

For these supporters of Big Bang reforms within the MoF, speedy financial liberalisation was the key to regaining Japan's status in international finance and Tokyo's role as a leading financial centre.

Mr Sakakibara has been a strong advocate of increasing the yen's role as an international currency. With the Euro expected to become the leading international currency after the dollar in a few years' time, the yen, and with it Tokyo, was likely to be relegated to second-class status unless something was done quickly.

"There was concern that the Japanese financial industry would fall behind New York and London, and that (to stem Tokyo's decline as a leading financial centre) would require very major and rapid reforms," recalls Yoshimasa Nishimura, who was director of the MoF's banking bureau until a few months before Mr Hashi-

moto's surprise announcement and is currently a professor at Waseda University.

That view was not necessarily held universally within the MoF. There were many MoF officials, including Mr Nishimura, who pushed for a more gradual approach to change that would aim to deal first with the problems in Japan's financial system, including the banks' huge bad debts. This group felt that "once those problems are addressed, Tokyo will automatically become a stronger financial centre," Mr Nishimura notes.

The views of this more conservative camp are more typical of the MoF's traditional, piecemeal approach to reform.

Nevertheless, in the end, the arguments for speedy liberalisation to maintain Tokyo's competitiveness won.

The victory of the MoF radicals is probably due in

part to the close personal relationship between the prime minister and Mr Saka and the surprising comeback of Mr Sakakibara, whose influence had previously been all but written off when he was appointed head of the Institute of Fiscal and Monetary Policy in 1994.

But at the same time, the spread of bureaucrat-bashing, focused on the finance ministry, is likely to have played a significant role.

"One of the major reasons why financial reform has come this far is because it came hand in hand with widespread criticism of bureaucrats," Mr Nishimura points out. "Fifty years after the war, there is a public consensus that the Japanese system has to change." It is against that environment that the need for rapid financial liberalisation won widespread public approval, he says.

There is another theory - that those MoF officials

who advocated rapid change saw Big Bang reform as a way to preserve the authority of the ministry, which had come under mounting criticism for its handling of Japan's financial problems and the corruption scandals that rocked the industry and the MoF.

According to this theory, reviving Japan's financial industry through rapid liberalisation was the key to overcoming growing calls to dismantle the finance ministry.

In any case, there seems no doubt that the turmoil in Japan's financial industry and its regulating body weakened resistance to far-reaching and rapid reforms.

Even politicians who would normally have been expected to lobby on behalf of those with vested interests in the financial industry, had little ammunition with which to resist calls for rapid reforms.

"Japan's financial system has reached a point where everyone recognises something has to be done," says Mr Nishimura. The scandals in the industry and the finance ministry and the clear decline in the competitiveness of Japan's financial industry has made it difficult for politicians who may want to postpone or even scrap Big Bang, to claim that Japan's financial system is fine as it is, he notes.

The problem is that while few people question that change is needed, there are serious doubts as to whether Japan is really ready for Big Bang. "I don't think it is a good time to go through with Big Bang. The industry is not strong enough and Big Bang will lead to destruction," says Mr Saito.

But even if Big Bang proves to be the disaster some people think it will be, as a bureaucrat-led initiative, few, if any, are likely to be called to account.

THE ECONOMICS • by Paul Abrahams

Ageing cohort needs faster growth, higher returns

The problem of Japan's rapidly ageing population overshadows most other issues

The economic rationale for Japan's financial revolution is evident. The system that provided such spectacular growth between the 1960s and late 1980s now appears incapable of delivering sustainable economic expansion.

The economy's lacklustre performance would be bad enough if Japan's requirements were static. But the country's rapidly ageing population needs faster growth as well as higher returns on its life policies and pensions if the elderly are not to become a huge financial burden for the economy in the next century.

The ageing issue overshadows the entire policy debate in Japan. The population is

already the second most elderly in the OECD (Organisation for Economic Co-operation and Development) area. Falling fertility rates have cut the number of young people, while improved mortality rates are set to increase the number of elderly. By 2025, the average age of the Japanese population will be the highest in the OECD. Brokers Morgan Stanley estimates the dependency ratio - the number of pensioners supported by members of the active population - will reach an astonishing 56 per cent by 2010, the highest ratio among the Group of Seven industrial democracies.

The question facing Japanese policymakers is how to support this ageing cohort. Their task would be made easier if the economy was expanding at its historically fast clip. But since 1992 the economy has badly underperformed.

Gross domestic product growth has been lacklustre and prospects are deteriorating. The Economic Planning Agency admitted last month that GDP growth in the year ending March 31 was unlikely to reach its target of 0.1 per cent, the first time in 23 years the economy will have contracted. The industrial Bank of Japan, admittedly the most gloomy of the leading banks, forecasts the economy will contract a further 0.5 per cent in 1998.

If the macroeconomic environment is dire, then the corporate sector's failure to deliver a meaningful return to investors is making life even more difficult for pension funds to meet their obligations.

Japan's corporate managers have traditionally been much more interested in stakeholders - employees, suppliers and customers - than shareholders, their owners. Until the 1980s,

the banking sector provided some discipline. But since then the companies have increasingly tapped capital markets for funds.

Obsessed with market share, rather than return on equity, the corporate sector invested that money in non-economic projects. This misallocation of capital has resulted in catastrophic cash flow and poor profitability.

The dividend yield on Japanese equities has always - or at least in living memory - been paltry, leaving investors to look to make most of their return from capital gains. This was fine during the bull market of the 1980s. However, the bear market since 1990 has left the Nikkei 225 average down more than 80 per cent.

Meanwhile, despite the collapse in stock prices, the market's dividend yield remains below a pitiful 1 per cent. Japan's corporations may have been habitually

disinclined to distribute cash to shareholders, but even if they wanted to, few could presently afford to do so. It is hardly surprising that Japanese pension funds' current rate of return is well below their 5.5 per cent target.

The economic requirement to revolutionise the financial system is clear. "What the Japanese were doing before has stopped working," explains Peter Tasker, strategist at Dresner Kleinwort Benson in Tokyo.

The theory is that once the antiquated financial industry has been liberalised, capital will be allocated more efficiently, the economy should recover, and returns on the ¥1,200,000bn of personal savings in Japan will improve. But doubts remain whether the reforms, in their present form, will be able to deliver. Jason James, strategist at HSBC James Capel in Tokyo, explains:

"In order to increase returns you have to have a mechanism to improve corporate governance. Share buy-backs as a method of returning capital are only just being introduced, and managers do not have an incentive to raise the share price because they do not own options. And if there is no carrot in the form of options, there is also no stick in the form of hostile takeovers."

Mr James believes there is little prospect of such a discipline entering the Japanese market because of the continuing importance of cross-shareholdings between companies, accounting for about 45 per cent of outstanding shares.



Middle-aged and elderly Japanese women at a health and beauty farm in Tokyo: life policies and pensions must perform better if the elderly are not to become a huge financial burden. (Anthony Johnson)

There is, moreover, a real danger is that in the short-term Japan's Big Bang could make the situation worse before it becomes better. "The consequences of Big Bang have been underestimated," says Mr Tasker. "It will create the possibility of massive cuts in capacity in both the banking and broking industries. The effect on certain parts of Japan of closing down some regional banks could be devastating. It is far from clear that the government is prepared to face the consequences of throwing people out of work."

Mr Tasker stresses the difficulties confronting policymakers: "They are trying to sort out the private financial sector at the same time as restructuring public sector financing - that's quite a lot at one time."

Moreover, there is a real danger that if the reforms do create changes, then the government will back-slide on its commitment to reform.

"Nobody knows how robust the Japanese economy is," says Pelham Smithers, strategist at ING Barings in Tokyo. "The proposals are as broad and flexible as possible, so that if anything becomes too detrimental it will be stopped. We've already seen backsliding in the case of Post

Office privatisation, which was stopped by interested pressure groups."

However, Mr Tasker believes that once the process begins, it will prove impossible to control. "There is no coherent opposition to Big Bang. You can't stop the changes in foreign exchange regulations; you won't be able to stop foreigners introducing new products; and you won't be able to end the freedom of choice of how to invest. Nobody is proposing anything else. There is no alternative."

Japan's future pensioners must hope the pain to come will nonetheless deliver the returns they need.

TOKYO AS A FINANCIAL CENTRE • by Vincent Boland

A place in the holy trinity

The implications for Tokyo's role alongside London and New York are enormous

Even in these recessionary times there can be no doubt that Tokyo is one of the world's great cities. From the shopping streets of Ginza to the sleek skyscrapers of Marunouchi, it contains the sort of concentrated wealth seen in few other capitals. Its streets hum with activity, its metro system is unbeatable, and its nightlife is unique.

Tokyo's financial market is important, too. But how important? Japan is the world's second-biggest economy, but what would the global financial markets lose if Nomura's headquarters were to be levelled by an earthquake (everybody says the Big One is coming)? Is Tokyo a match for New York or London? Does it want to be? Is that what Big Bang is all about?

Japanese officials are somewhat ambivalent about what exactly Big Bang is supposed to do for Tokyo as a financial centre. Students of economics and finance, asked to name the three leading financial centres, would already surely reply by naming New York, London and Tokyo, probably in that order. On that basis, there appears to be little need for a Big Bang at all. But that is not the point.

The point, officials and bankers say, is that deregulation will make Tokyo more useful to the Japanese econ-

omy as much as to the world, and especially in Asia, where it has been facilitating growing competition in recent years from more nimble centres such as Hong Kong and Singapore.

"Clearly, there is international interest in Tokyo as an international market, and we are pleased to see that this trend is occurring," says a senior official at the Ministry of Finance (MoF). "We would like to make Tokyo as global as London or New York."

"But in the end, London is truly global while the New York market retains a lot of the characteristics of a national, US market. I see Tokyo as being more like New York than London."

There can be no doubt that Japanese financial sector executives and government officials have learned a lot from studying the effects of Wall Street's "May Day" reforms and the UK's Big Bang. But many observers, and not just locals, argue that the pace of technological change since these financial "revolutions" will mean that the impact of Japan's Big Bang will change not just its financial sector but its entire economy and way of doing things.

Betsy Daniels and Hideyasa Ban, analysts at Morgan Stanley, wrote last August that because of the development of technology, what Japan is proposing is unprecedented.

"Other economies were luckier," they noted. "Deregulation of financial institutions occurred before there was technology that allowed the marketplace to

register time in fractions of a second. Japan's Big Bang will severely test the flexibility of Japanese financial and non-financial corporations alike."

The implications for Tokyo's place in the holy trinity of financial centres are clearly immense. Not surprisingly, the government has been criticised for not spelling out what it intends to achieve by making the financial markets "free, fair and global", in the words of Ryutaro Hashimoto, the prime minister whose initiative this is.

There have been complaints that Big Bang inevitably means bankruptcies, closures and collapses, such as that of Yamaichi Securities.

Officials counter that such criticisms miss the point. "There is an impression that what is being introduced is not a Big Bang unless a lot of institutions restructure or fail, but that is not its essence," says Akira Ariyoshi, director of the research office at the securities bureau in the finance ministry.

"Because of the weakness of a lot of institutions, financial restructuring has come to the fore. Crisis management is not related to Big Bang. It may have accelerated people's decision-making but it did not create their problems."

"We have been criticised for not showing people a post-Big Bang landscape. We're trying to move away from that. The whole exercise is meant to create a framework where those institutions that can provide

the best services and products get the opportunity to do so."

If Mr Hashimoto's vision is realised, Tokyo will be no different from New York or London. And even if some western observers remain privately sceptical, worrying in particular that what emerges will be free and global but may not entirely be fair, others say Japan is truly at a turning point.

"Anyone who has been observing these issues in Japan for a long time has to start with a certain degree of scepticism," says Matthew Goodman, vice-president and director of government affairs at Goldman Sachs in Tokyo. "But this commitment is different. It reflects a much deeper consensus that the old system doesn't work any more and that change is needed."

There is certainly no shortage of advice for bureaucrats plotting the legislation that will make Big Bang a reality in Japan's generally introverted financial markets. But the acceptance of change, and the need to open the market to foreign competition, appears to be widely accepted, bankers say, although whether Tokyo really does become a free, fair and global market remains to be seen.

"I think the contribution of foreigners is going to be seen as positive," says John Baldwin, chairman and general manager of Jardines Fleming Securities in Tokyo. "There has been a great deal of learning over the past five years and people are now more prepared to say 'Yes, the foreigners were right'."



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LOGISTICS • by Gillian Tett

Complex timetable for reforms package

April 1 is the first big milestone, although some measures are already operating

Japan's financial deregulation might have been dubbed the "Big Bang" but in practice it will be more like a long series of "pops" than a single explosion.

The package of "Big Bang" reforms that has been drawn up by the government includes a bewildering multitude of complex changes. These affect not only the banking sector, but securities and insurance business as well. Meanwhile, the timetable itself is spread out over five years, stretching to 2001.

The legislation produced by the Ministry of Finance to support the changes covers a total of 2,129 pages – a stack of paper 8cm thick and weighing in at 4.4kg.

But behind the mass of detail, several clear themes can be identified. In essence, the basic objectives of the reforms are to:

- Tear down the existing barriers between different categories of financial business, by letting insurance, banking and securities business compete with each other;
- Ban cartel-like behaviour such as fixed brokerage commissions;
- Allow financial institutions more freedom in offering innovative financial services such as derivatives;
- Encourage financial industry restructuring by allowing the use of financial holding companies;
- Reduce transaction costs by cutting items such as securities transaction tax;
- Remove asset allocation rules for pension funds; and
- Promote greater transparency in corporate accounting.

Some measures to implement these reforms have already been introduced – even before Big Bang officially gets underway. During the course of fiscal 1997, for example, single stock options were introduced. Banks were allowed to rent out space to asset management companies to sell mutual funds. And some of the existing rules on pension fund allocation have been steadily relaxed over the past two years.

However, the first big milestone – and the official starting point for the Big Bang – is April 1. This is the date when two key reforms occur: the relaxation of foreign exchange controls and partial liberalisation of brokerage commissions. These changes have a particular symbolic significance because they were the crucial triggers for the financial deregulation that took place in London and New York.

The foreign exchange reform, for example, is important because at present a multitude of restrictions exist on capital movements in and out of Japan. The only companies allowed to

carry out foreign exchange business are authorised banks.

Companies or individuals wishing to move more than ¥5m across borders must first seek approval from the Ministry of Finance. And foreign exchange "netting" – a practice whereby several different transactions are consolidated to save money – is difficult. (Although netting was not technically banned, the legal status of it has been unclear and so many companies have been reluctant to employ it.)

However, the Big Bang reforms will change this. Later this year the legal status of netting will be confirmed. On April 1, restrictions preventing non-banks conducting foreign exchange business will be lifted. And from April 1 prior approval for foreign exchange transactions will be unnecessary.

This could have significant impact. Brokers and trading companies, for example, are likely to develop their own foreign exchange businesses – meaning that they will no longer have to pay fees to banks. The introduction of netting will also cut corporate costs. Indeed, the government calculates the two measures could save ¥175bn a year for companies.

But the biggest potential impact is in domestic savings. For after April 1 investors and companies should be able to use overseas financial services more easily. In essence, they will be free to place their money in higher yielding bank accounts, investment trusts or life insurance contracts anywhere in the world.

Some observers fear this could lead to a massive capital flight out of Japan. But it is not clear yet how big the impact will be because domestic companies are scrambling to make themselves more attractive, to compete. And so too often in Japan, there is a crucial catch: although the government no longer demands prior approval for moving funds, it is introducing reporting requirements after the event. This stipulates that banks or brokers must report any movements worth more than ¥2m to the tax office.

What the tax offices will do with this is unclear: they do not currently have enough staff to track such flows. But if the new system is perceived as a way to curb tax dodging, it could reduce the size of potential capital flows.

The other eye-catching reform on April 1 – liberalisation of brokerage commissions – is similarly complex. Commissions for transactions over ¥1bn have already been deregulated. However, on April 1 commissions on transactions down to ¥50m will be removed.

This step could also have huge implications for the brokerage sector: analysts are currently forecasting that commissions could fall by 30 per cent to 50 per cent. This could hurt smaller Jap-

anese brokers who depend on commissions for revenues. But the impact may only become apparent over a long period because commissions below ¥50m will only be liberalised in late 1999 (the precise date is unclear.)

Meanwhile, some western brokers have already been quietly discounting their listed fees, or conducting business offshore for clients at lower cost even before April 1.

Aside from these changes, other reforms will also come in on April 1. A new system of bank accounting and monitoring will be introduced. This system, known as Prompt Corrective Action, will demand more disclosure from the banks, and give the Japanese authorities the right to close down any banks which do have sufficient financial strength.

The system was due to be imposed on all banks in fiscal 1998 but was recently delayed for a year for the domestic banks because of fears that they were too financially weak to meet the new standards.

Also in April a 50-year-old ban on financial sector holding companies will be lifted.



The Ministry of Finance produced 2,129 pages of legislation

This move may encourage a host of banks, brokers and insurance groups to create holding companies. However, there is yet another catch: consolidated tax payments are not allowed in Japan at present, meaning that there is little tax attraction in making the switch.

Parts of the Ministry of Finance want to change the tax system. But the budget bureau has hitherto resisted.

Further changes will take place during the course of fiscal 1998. In the early summer, a new financial supervi-

sory agency will be set up. Precise details about how this will operate are still unclear but it will effectively remove many of the supervisory powers from the MoF, although it appears that its staff will be taken from the ministry.

Towards the end of calendar 1998 (the precise date is not yet fixed) another wave of legislation will come in. One key change is that banks and securities companies will be permitted to start mutual fund (or "investment trust") busi-

nesses for the first time. Shortly after this, insurance companies are also likely to be given permission to distribute mutual funds.

This step could have an important impact on the mutual fund business, which is strikingly underdeveloped in Japan. At present, mutual funds can only be distributed by brokers. However, if banks and insurance companies are allowed to enter the business as well, the distribution channel will surge.

And as a further spur to the industry, the range of

mutual funds that can be sold will be broadened: private offerings, for example, will be permitted for the first time.

Another change, scheduled for late in 1998, is that the licensing system for securities companies will also be reformed. Instead of having to apply for a formal licence, companies will only have to register with the government. The aim of this is to make it easier for companies to enter the securities business. However, capital adequacy requirements will also be tightened for securities companies. This will make it easier for the authorities to close down companies which are financially weak.

At the same time, non-bank financial institutions will be allowed to issue corporate bonds. This should make it easier for the consumer loan companies, for example, to raise funds for their businesses.

Then, in fiscal 1999, more reforms occur. Perhaps the most important will be that securities companies and trust banks will be allowed to enter each others' businesses through subsidiaries. The aim of this is to foster

new competition across the sector, but it is also likely to reinforce the trend towards the creation of universal financial service companies.

The final batch of reforms will occur in fiscal 2000 and largely affect the insurance industry. These reforms have been delayed until the last part of Big Bang largely because of intense opposition from the insurance sector. An additional complicating factor is that Japan has recently been involved in negotiations with the US over the liberalisation of the sector from a trade perspective.

But the Big Bang timetable stipulates that by the end of 2001, insurance, banking and securities companies will be allowed to enter each others' businesses through subsidiaries. This will ensure that all the remaining barriers between different financial sectors are removed, providing another spur to competition.

This, in effect, will mark the final stage of Big Bang – assuming, of course, that an already complicated timetable does not become delayed or any more complex between now and 2001.

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BIG BANG SCHEDULE

Fiscal 1997:

Options trading in individual stocks introduced. Asset management accounts at securities firms permitted. Holding companies permitted; initially restrictions on financial holding companies, but it is planned to remove these later.

Fiscal 1998:

Brokerage commissions on transactions over ¥50m liberalised. Foreign exchange operations, overseas deposits and cross-border securities transactions liberalised. System of "prompt corrective action" introduced to force troubled financial institutions to take early, corrective action. Bank of Japan given nominal independence to set interest rates. Securities and Exchange Surveillance Commission powers strengthened and penalties for financial transgressions toughened. Rating agency for insurance brokers reformed. Restrictions on securities derivatives lifted. Licensing system for securities brokers abolished to encourage the entry of new participants. Banks permitted to start selling investment trusts. Financial institutions allowed to establish special purpose companies in Japan for the purpose of asset backed securitisation. Non-bank lenders allowed to issue straight bonds.

Fiscal 1999:

All stock trading commissions liberalised. Business restrictions on brokerage houses and trust bank subsidiaries lifted. Ordinary (or "city") banks permitted to make straight bond issues. Corporate accounting system will shift towards one based on consolidated, and mark to market accounting.

Fiscal 2000:

Real time gross settlement banking payment system introduced in Tokyo to improve the short-term money market.

Fiscal 2001:

Banks permitted to sell some forms of life insurance. Banks and insurance companies able to enter each others' businesses through subsidiaries.

Source: reports from the Japanese government's advisory panels on the securities, banking and insurance sectors

4 JAPAN'S FINANCIAL REVOLUTION

PROFILE Kanto Securities

Speculating at the sharp end of the securities market

Gambling is officially frowned upon by the Japanese authorities, so people invest in the stock market instead. But will the arrival of deregulation spell the demise of the numerous discount brokerage houses that fulfil the nation's innate desire to punt?

At the smoke-filled offices of Kanto Securities in central Tokyo one recent morning, speculation was in full swing as a hard core of the firm's 2,000 customers congregated around flickering screens. Kanto is one of the many firms that rely almost exclusively on commission income for survival, and its executives are predicting some tough times ahead when fixed commissions are abolished next year.

It is at this end of the securities market, with virtually no exposure at the moment to foreign competition, that resistance to Japan's Big Bang is strongest, although most are not in any position to influence its timing or outcome.

"We are forecasting a drop in commission income of 40 per cent, so we are worried and concerned," says Tadatoshi Kondo, president of Kanto. "If our commission income falls by that much, it will cost us ¥600m over three years."

The 30 or so people in the office that morning are among about 300 people - Mr Kondo describes them as "more or less semi-professional investors" - who are responsible for the bulk of the firm's commission income. Kanto had total revenues of ¥943m in the year to March 1997, of which ¥673m came from commissions.

"These customers are free to choose what they

want to buy and sell. For a small business like ours, it is important to maintain this type of business," he adds.

Across Tokyo, however, there is growing speculation about what the fate of these and other small brokerages will be once commissions are liberalised. There is one small ray of hope for them - in the US and the UK after their versions of Big Bang, commissions on small retail transactions actually rose after deregulation. But even if that happens, it may not be enough to make up for the loss of business to larger, more professional and perhaps safer firms that is expected to be the trend as deregulation takes hold. That is why some firms, including Kanto, are looking to merge with similar rivals to gain market share and a firmer foothold in the new market.

Earlier this year Kanto and Dofma Securities, a discount house in Osaka, announced that they were to merge, in what may be the first of many such transactions in the coming months. Mr Kondo describes the merger as a strategy for surviving Big Bang, a strategy that will have to be embraced by other discount brokers after years of losses caused by the stock market slump. "This merger is a sincere hope that we will continue to survive after Big Bang, but I am more worried than confident," he says. Nevertheless, Mr Kondo is counting on the patriotism of the Japanese, and especially of his type of investor, to shun the blandishments of foreign competitors and remain loyal to firms such as Kanto.

Vincent Boland

THE BROKERS • by Vincent Boland

Difficult days for securities houses

The brokerages depend heavily on commissions which are due to be abolished

After the collapse of Yamaichi Securities at the end of last year, the lesser-known firm of Kokusai Securities was propelled into the spotlight by taking its place as Japan's fourth-biggest securities company, behind Nomura, Daiwa and Nikko.

It is a position that makes Koichi Kane, Kokusai's executive managing director, a little uneasy. "We never wanted to be in the top four, but we are now. Quite frankly, market share has never been our aim, but profitability is. In that sense we are somewhat unique."

Because there are difficult days for Japan's faded securities houses - a moribund stock market, the imminent ending of fixed commissions, intense competition, and the ever-present threat of scandal - the league table has never been more fluid. And not all the surprises the industry is facing are likely to be as pleasant as Kokusai's sudden elevation to the top rank.

Japan's brokerages are heavily dependent for their income on fixed commis-

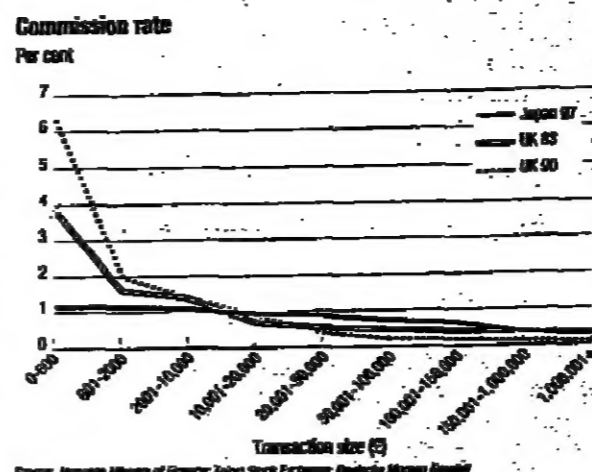
sions, which are to be abolished with deregulation of the country's financial markets. How they will cope when that finally happens next year is the question they are all now asking.

Survival is assured for some, such as Kokusai, and Kosei Securities, an aggressively lean firm in Osaka. For others, a painful readjustment, if not a painful exit, is in prospect.

"Japanese securities companies have to introduce measures to increase revenues," says Yasuo Kanazaki, chairman emeritus of the Nikko Research Centre. "They will have to switch to fee income and away from commission income. That will put the emphasis on total asset volume rather than on portfolio turnover."

At the same time, other observers add, they will have to control and cut costs and expand the range of products they offer the customer. Doing all of these things together, and successfully, will be a tall order for many firms.

To be fair, some are already working on post-Big Bang strategies. Alliances are emerging between local and foreign firms to develop and sell new products, especially mutual funds, and "wrap" accounts, to capture a bigger share of Japan's enormous personal savings



Source: Japanese Ministry of Finance; Tokyo Stock Exchange; Daiwa Securities

market. This is valued at ¥1,200,000bn, a number that slips easily from every Japanese banker's tongue, and the vast bulk of it is in cash deposits or post office savings schemes.

Today, Kokusai claims a 25 per cent share of the mar-

ket for sales of investment trusts managed by western investment banks such as Goldman Sachs and Morgan Stanley. Its target market is rich individuals seeking more professional management of their wealth.

It also has a niche position in initial public offerings and bond trading, and along with Kosei and Nomura, which owns 33 per cent of Kokusai, is much less dependent on income from commission than other firms.

The result, according to a report in February by Deutsche Morgan Grenfell, is that Kokusai is "one of the few major brokers outside the Big Four with a decent earnings record." Firms of a similar size, such as New Japan,

Kankaku and Wako, have not been so fortunate.

Others are now seeking to copy Kokusai's formula. Daiwa Securities unveiled its own Big Bang strategy at the end of last year that includes reorganising management, increased investment in technology, developing a global product line including investment banking, introducing the bonus system of rewarding staff, and allowing staff over 50 to retire earlier than the statutory age of 60 if they wish.

The strategy "is all based on the understanding that we will not survive intense competition without it," says Shinichi Yamamura, Daiwa managing director and board member.

Daiwa, Kokusai and a handful of others are either big enough or nimble enough to survive. But Japan's large number of under-performing or loss-making securities firms could be the real losers after Big Bang.

Those most dependent on equity trading, which in large measure consists of little more than churning portfolios to earn commission, will be hardest hit. Experience from the US and the UK shows that most commissions, except for small retail transactions, fall sharply after deregulation. Japan is likely to be no dif-

ferent. "There are too many securities houses. I would not be surprised if a third of them went under," Mr Kane says.

"The marginal firms must consider rationalisation, because I don't necessarily see retail commissions rising as they did in the US and the UK when institutional commissions fell."

If vulnerable firms are unable to guarantee their survival independently, they may find security in the arms of Japan's commercial banks. Big Bang will allow the banks to develop their own securities businesses, and their retail networks will give them a powerful advantage in selling to new customers.

However, executives at securities firms generally sound lukewarm in discussing the possibility of being taken over.

One growls: "We have nothing to learn from our Japanese competitors." Instead, as outlined by Goro Tatematsu, chairman of Kosei Securities, firms need to focus more on what their clients need and develop products that can be sold. "We should think in global terms in developing new products," he says. "Just having an investment market of ¥1,200 million million is not enough in itself. We have to add value."

THE BANKS • by Gillian Tett

Rivalry to replace cosy collaboration

The competitive battle seems to be starting. Painful choices will now have to be made

A few months ago, Sanwa Bank, one of Japan's largest, took an innovative step. With Big Bang looming, it proudly announced it would offer customers a service no other Japanese bank had done - telephone banking.

What happened next took Sanwa by surprise. Sumitomo, another huge bank, promptly started telephone banking as well - precisely one day before Sanwa. "We wanted to show we could be first," says a Sumitomo executive cheerfully.

The tale might seem trivial. But it points to a wider - and potentially momentous - shift in Japan's banking world.

Until now Japan's banks have operated through cosy collaboration, not rivalry. But Big Bang promises to create a newly competitive climate. As the banks scramble to respond, the uncertainty now is whether this competition will leave the banks looking stronger than

before - or whether the attempt to make Tokyo a globally competitive financial centre will take place at the expense of the domestic banks.

Drastic change is certainly needed because, with or without Big Bang, the fact is that Japan's banking system is currently in a mess. The basic problem is that during the past five decades the government has developed the financial sector around a national goal of directing savings to manufacturers, rather than building profitable banks. Banks, for example, have maintained close links with customers through cross-shareholdings. Competition has been reduced by a so-called "convo" system in which strong banks were expected to support the weak.

Businesses were strictly segregated: Japan's three long-term credit banks provided long-term lending; the 10 "city" banks focused on retail business; the seven trust banks offered asset management services; and a mass of regional banks serviced local clients.

This pattern worked when Japan's economy was grow-

ing rapidly. But it is now in crisis. The bursting of the 1980s bubble has left the sector weighed down with huge problem loans, currently put at some ¥77,000bn. The falling stock market has slashed the value of the banks' equity portfolios, which the banks count towards their capital.

Meanwhile - and most crucially - the banks' business franchises are vanishing. Japanese companies no longer rely exclusively on the banks for funding: since 1993, companies have increased their reliance on capital markets from 29 per cent of funding to 42 per cent.

Spreads on corporate lending have slumped. And though some banks have wanted to diversify, they have been prevented by industry segregation. Most banks have been increasing, not shrinking, their loans in recent years. Consequently, David Atkinson of Goldman Sachs, calculates that even if the Japanese banks cut all costs, their ROE would be a shockingly low 19 per cent, compared with 30 per cent in the US and 68 per cent in the UK.

Can Big Bang change this? Some reforms may help.

Tearing down industry barriers, for example, will allow banks to enter new businesses, such as asset management. Introducing holding companies could allow more efficient management. And irrespective of actual deregulation, the debate about Big Bang is ushering in a new willingness to flout the "convo" system.

Meanwhile, the banks are scrambling to show investors that they have new strategies, spurred on by a plunge in their share prices last year.

Nippon Credit Bank, for example, has decided that it wants to target smaller companies. Yasuda Trust is withdrawing from overseas business. The Industrial Bank of Japan is trying to turn itself into an investment bank. Sumitomo Bank is trying to become a leading distributor of mutual funds.

This is encouraging, until recently the banks rarely talked about specialist business niches or shareholders. But it may not, in itself, solve the banking sector's woes. For if the banks are to become competitive by west-

ern standards, they must address other issues.

One is their bad loans. All are now pledging to make huge write-offs in the 1997 fiscal year that is forecast to leave the top 19 banks collectively recording ¥3,608bn worth of losses in fiscal 1997. But the banks are still proving painfully slow to actually realise the loss by selling the land they hold.

Another is their management style. This has traditionally been very hierarchical, with pay set by age and staff rotated frequently between jobs. But globally competitive banks require highly motivated specialists.

Some Japanese banks are now reforming their personnel system along these lines but none has yet made serious job cuts. Meanwhile, many are losing good staff to western competitors who offer better pay.

But the biggest issue of all is the sheer number of banks. Margins are currently low because too many banks are chasing the same business. There are hints that this is changing: a few regional banks have recently closed or merged. Last autumn, Japan saw some-

thing hitherto considered inconceivable - one of its top 20 banks, Hokkaido Tokai-Mitsubishi, collapsed.

But reform, as so often in Japan, is painfully slow. The government now insists that no other big bank will be allowed to fail. Indeed, this month it agreed to pump some ¥1,800bn into the banks - both weak and strong - to increase their capital base. Government officials argue that if capacity is taken out of the system, it should be done not through outright failures, but through mergers and the creation of holding companies instead.

This might work - over time. But time is not something the banking sector has.

If Japan can accept a wave of consolidation, then the strongest banks could flourish. If it cannot, then the country's banks will stagnate - and Japan will see a half-hearted Big Bang. Either way, Sanwa and Sumitomo's rivalry over telephone banking is one sign the competitive battle is starting. The country now has some painful choices to make.

LIFE INSURANCE COMPANIES • by Bethan Hutton in Tokyo

Yet another challenge

The threats and opportunities offered by deregulation are only one concern

The Big Bang for Japan's insurance industry may actually have been heard a year ago, when Nissai Mutual, a life insurer, collapsed.

The Hashimoto Big Bang is just another step in a series of challenges which have faced the industry over the past decade. Foreign pressure, particularly from the US, has already led to the opening of Japan's insurance market to foreign firms, as well as starting to break down barriers between competitors in different sectors domestically.

Those moves have been gradual. But the sudden collapse of Nissai Mutual, a medium-sized life company, in April last year, dramatically rocked complacency about Japan's insurance industry among consumers and in financial circles.

It also illustrated how Japanese life insurers have slipped from being international financial giants to struggling companies overburdened with bad loans and with capital bases weakened by years of paying out more in guaranteed returns to policyholders than they were making on their own investments. International ratings agencies have recently issued pessimistic reports on the life sector; several companies were given highly marginal ratings.

Nissai Mutual's downfall hit unsuspecting policyholders, who had assumed

that because the company was regulated by the finance ministry, their money was safe. In fact most will lose a large proportion of their money because there was no guarantee scheme for insurance policies in place.

This realisation shocked Japanese consumers. Into looking more closely at their insurance arrangements. New business is down at all life companies, and policy cancellations have been running at record rates, with the trend particularly noticeable at the smaller, weaker insurers. American Life Insurance, one of the longest established foreign insurers in Japan, now emphasises in its advertising that it is AAA rated.

At the same time as other regulations are being relaxed, the government is planning new legislation to help prevent more collapses, and protect consumers if they should happen.

Firstly, the finance ministry will monitor the solvency levels of insurance companies, particularly life insurers, more closely. It became clear after Nissai Mutual failed that the company had been insolvent for months, if not years. The new system will force insurers to disclose information about their financial status to regulators, who can then insist on prompt action to deal with the problem, rather than allowing business to continue as usual.

And in case this early warning system does not prevent further collapses, "policyholder protection corporations" are due to be set up, funded by compulsory contributions from insurers.

They will cover at least 90 per cent of policyholders' funds in the event of an insurer's collapse.

The funds should be up and running by December this year.

Meanwhile, deregulation has already increased opportunities for these companies willing and able to take advantage of them. Life companies are being allowed to move into the non-life sector, and vice versa, while the third sector - areas such as critical illness coverage - which has long been the home territory of the foreign insurers, is to be opened up to all comers.

Some domestic companies seem to prefer the status quo, however, and have been unwilling to move aggressively into new markets. Foreigners are not so shy. Some, such as AIG, have been active in Japan for a long time.

One thing the foreign companies bring with them is a more advanced approach to underwriting and policy design. Previously, Japanese insurers had a "one size fits all" approach - there was little differentiation in premiums to take account of varying risks.

Premiums also hardly varied between companies because competition was mainly on the strength and persistence of the sales force, together with the insurer's relationships with other companies. Now, deregulation is making discounting, innovative policy design and risk-weighted premiums possible, with foreign insurers leading the way.

They were the traditional home for a large proportion of Japan's savings, both from individuals, through savings-linked insurance products, and from pension funds, which entrusted their funds to life insurers to manage. That is changing.

With Big Bang, individuals will be given a far greater array of savings products to choose from, including ones in different currencies and investing in new instruments. Poor returns from insurance policies mean that the insurers will be struggling to hold on to much of that business.

The options for pension funds have already been broadened to include foreign investment advisers, and the remaining limitations should soon be lifted. There are already signs that more pension funds, both private and public, are turning to foreign investment managers. Their investment returns are consistently better than Japanese life companies, which have much more conservative investment policies.

One life insurance analyst says that the changes expected under Big Bang will accelerate the general trend towards differentiation in the market, helping the strong companies become stronger, and pushing the weak ones closer to the edge.

But the threats and opportunities offered by deregulation are just one of Japan's current concerns. Their financial state and poor investment returns may be much more significant, at least in the short term, than any loosening of the regula-

PROFILE

Striking record of growth in profits

Not many chairmen of Japanese financial companies have reason to look cheerful these days. But Yasuo Takei, chairman of Takefuji, Japan's largest consumer finance group, is currently one of them.

Mr Takei's company has just achieved something that has eluded Japan's banks and brokers - three consecutive years of strong profit growth. "We expect more growth this year," he says. "Our business seems recession-proof."

Such a record is striking, given that Takefuji is barely known outside Japan. But it highlights a feature of Big Bang: "outsiders" may be winners in the forthcoming financial changes.

Big Bang will allow new companies, such as trading companies and consumer loans groups, more freedom to enter Japan's financial sector. And in some cases these newcomers may prove more nimble in adjusting than the traditional banks and brokers.

Takefuji's story is striking - and shared by many of the non-bank financial companies, such as From, Acom, Nichel and the Shokoh Fund.

Mr Takei set up the consumer finance company in the late 1980s, after he noticed that consumers found it hard to obtain short-term loans in a hurry because of the rigid bureaucracy of the banks. He cuts a very different figure from Japanese bank-

ers; he speaks with a directness unusual in Japan, and sports a subtly striped suit instead of the usual dark attire. Nevertheless, his business has grown: last annual loan growth has exceeded 12 per cent in five of the past six years, and the company has 2.3m customers. Pre-tax profits have surged from ¥68.8bn to ¥121.2bn between 1995 and 1997.

This success has partly occurred because being outside the traditional government-protected financial hierarchy has allowed Mr Takei to avoid many of the problems of the Japanese banks.

The company is not weighed down with huge bad loans. It has been innovative in introducing new services, such as late opening loan dispensers. And whereas banks and brokers hire very few women, 30 per cent of Takefuji's branch managers are female - which allows the group to attract good skills at a lower price.

With Big Bang looming, the company is now trying to win more mainstream acceptance. Although it was 77 per cent family owned, Mr Takei recently sold about a tenth of his shares and wants to list on the TSE first section. He is particularly targeting foreign investors. "Foreign institutions seem to understand our business better," Mr Takei says.

Gillian Tett

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INVESTMENT BANKING • by Vincent Boland

Why Tokyo's bankers are definitely not for tennis

The 'Wimbledon scenario' is just one worry associated with Japan's Big Bang

A decade after London's financial markets were thrown open by its own Big Bang, the dominant investment banks are American. The City of London is a global financial powerhouse but many of the great names of British finance - Phillips & Drew, Rowe & Pitman, Morgan Grenfell and Hambros - have vanished or will soon do so, gobbled up by foreigners.

Japanese investment bankers refer to this as "the Wimbledon scenario", by which they mean that Britain hosts the world's best tennis tournament, but a Briton never wins.

Not surprisingly, they say

that what happened in London could never happen in Tokyo.

Perhaps they are right. Tokyo's investment banks are more important to the Japanese economy than London's ever were to the UK's, and Nomura, Daiwa and Nikko now have a global presence. More importantly, they have a vice-like grip on their domestic market, even if it has been sustained by heavy regulation and a fair degree of inertia.

And yet there is no escaping how worried Tokyo's financial sector is by the threats inherent in Japan's Big Bang. The country's vast personal savings market will be thrown open to competition from foreign houses. Its leading companies will be free - indeed, may be forced - to look to the likes of Goldman Sachs, Morgan Stanley or Merrill Lynch for mergers and acquisitions advice.

The lifting of exchange controls will mean capital is free to move abroad. And the technological prowess of western houses could give them a definite advantage.

In one sense, the cards appear to be stacked against the locals. Japan's investment banks are already free to virtually do as they please, and Big Bang will bring few opportunities to do things they cannot do already.

Foreign banks, on the other hand, can hardly hide their excitement. Deregulation will create a level playing field for everybody, and it stands to reason that those institutions that have been handicapped up to now will gain the most.

"Foreign banks had 20 per cent of Tokyo stock exchange turnover in 1996. In 1997, it was 30 per cent. There is a very good chance we could go to 40 or 50 per

cent," says a western investment banker.

"Many Japanese companies are saying they don't need more than one Japanese broker and are choosing a foreign bank to act alongside. Foreign houses are the best suppliers of quality research. And there isn't the depth of trading skills on the Japanese side."

In an already crowded marketplace, competition is about to get even tougher. "There are some 20 integrated investment banking houses in Japan," says Yasuo Kanazaki, chairman emeritus of the Nikko Research Centre. "When the market is deregulated, I don't think more than five can survive. Houses will have to merge or be taken over. There will be rationalisation."

Some foreign investment

banks have already made strategic moves into the market ahead of full deregulation. Merrill Lynch has acquired most of the retail arm of the failed Yamaichi Securities and is to spend \$300m building a retail business to capture a slice of the personal savings market.

"I am encouraged by Merrill's move. It shows the investment banking infrastructure is being developed," Mr Kanazaki says, adding that 80 per cent of all mutual funds distributed by Nikko in the past three months were invested abroad and managed by others.

Western bankers say asset management is a huge growth area for locals and foreigners alike. Traditionally, Japanese fund managers have underperformed their foreign rivals not just because the domestic stock market is in a slump but

because the sector has been so tightly controlled. Deregulation will shake it up a great deal, offering the ill-served Japanese consumer of financial products more choice.

And because foreign-managed funds can offer higher returns, foreign asset managers say they are in a much stronger position to exploit the market.

"Most of our Japanese competitors are behind the curve," one says. "Asset management is an underdeveloped business here compared to overseas. We have a real advantage because we are equipped with modern marketing expertise and the ability to generate much higher returns than are available from Japanese asset managers."

Few foreign bankers would claim to be able to displace Nomura Securities from its position as Japan's

leading investment bank, at least in its traditional business of trading, acting for Japanese companies, and selling to retail customers. Instead, they are focusing on innovation - offering products that Japanese clients have not been able to use up to now.

If Japan's Big Bang means anything, it means that new products will be easier to develop and market. The definition of a security will be broadened and, in legal terms, deregulation will mark a significant shift towards permitting any innovation that meets the usual prudential considerations and is not specifically prohibited.

"Big Bang is going to enhance the scope for innovation in new products and services," one banker says. "Two areas in particular are derivatives - indeed, deriva-

tives of all kinds - and securitisation, where a domestic market has never really developed for regulatory and tax reasons. It has started already and I think it is going to be a very big business."

Given the power and reach of firms such as Nomura, Daiwa and Nikko within their home markets - and, for example, Nomura's principal finance group in London - their staying power should not be underestimated. Nor should the lessons learned from the collapse of Yamaichi be overlooked.

Japanese bankers agree that Yamaichi was an enormous shock to the system, concentrating minds wonderfully ahead of Big Bang. If anything, it has strengthened the resolve to avoid, at all costs, a repeat of the dreaded "Wimbledon scenario".

MUTUAL FUNDS • by Gillian Tett in Tokyo

Spreading a new gospel

The sector could offer some of the most enticing prospects for foreign companies

In the downtown Shinjuku area of Tokyo this spring, Michiko Masuoka is spreading a new financial gospel. Several months ago, Fidelity, the US mutual fund group, took advantage of a reform in the Big Bang deregulation to set up a marketing point in a branch of Sanwa Bank - one of the first ever seen in a Japanese bank.

Now Ms Masuoka is trying, after a few weeks of training by Fidelity, to explain a concept that most Japanese have hitherto been unfamiliar with - using mutual funds for long-term savings plans.

"It's a different way of thinking for us in Japan," Ms Masuoka says, sitting in a smart new booth, where she is currently meeting about a dozen Japanese customers each day, mostly men in their thirties and forties. "But I think people are interested," she adds.

The ¥60,000n question, though, is just how interested? As Big Bang gets under way, the mutual fund sector could potentially offer some of the most enticing prospects for foreign companies. For although mutual

funds have been strikingly underdeveloped so far in Japan, hopes are rising that the country could see rapid growth, like that in the US, in the coming years.

But retail financial services is also a business area deeply embedded in Japanese culture. Consequently, the crucial issue now is just how quickly western companies will be able to persuade the Japanese public to adopt "foreign" concepts such as US-style mutual funds?

There is certainly a strong incentive for western companies to try. Japan's consumers are famously estimated to have some ¥1,200,000n worth of savings. But most of this money is placed with Japanese banks, brokers, life insurance companies and the national post office, which generally yield very low returns. Mutual funds (known as investment trusts in Japan) account for a mere 3 per cent of all savings. This is a quarter of the US level - and is actually lower than the proportion in Japan in the late 1980s.

However, there is now growing pressure for change. The media coverage of Big Bang has left many Japanese consumers more aware than ever before about investment alternatives and Big Bang itself will usher in reforms designed to promote the mutual fund sector.

Later this year, for example, banks will be permitted

to sell mutual funds for the first time. Insurance companies will probably follow a year later. As an interim step, banks were allowed to rent space to investment companies last year - a change which permitted Fidelity to establish its booth in Sanwa.

Akira Ariyoshi, director of the Ministry of Finance research office says: "What we are doing is providing alternatives to bank and life insurance products which have low fixed rates of interest."

Japanese companies are scrambling to respond. But mutual funds are one area where foreign companies have distinct advantages, because western companies already have a long experience in the sector. And the poor performance of Japanese instruments in recent years is leading many consumers to look to non-yen investments - an area where western groups are particularly strong. In the past year alone, for example, monthly sales of non-yen money market funds have risen six-fold to ¥230bn, of which the vast majority are managed by western groups.

This logic has already left many western companies expanding their operations. These include a host of well known US and European mutual fund groups and investment banks, such as Merrill Lynch, Mercury

Asset Management, Schroders, Putnam, Invesco and Smith Barney. "We think the opportunities here are huge," says Steven Spiegel, Putnam's senior managing director.

It also includes some surprising operators; although Goldman Sachs usually considers itself an investment bank it now has one of the fastest growing mutual fund businesses of any foreign group in Japan.

But turning this excitement into actual sales will not be simple because although western companies have many advantages over their Japanese rivals, they also face two distinct problems.

One is distribution. Until now, western companies have been forced to sell products through domestic brokers. But these have often charged high fees and sometimes been reluctant to sell competing foreign products. Allowing banks and life insurance to enter the mutual fund market should dramatically expand the distribution channels, but banks and life insurance companies have limited experience of actually selling mutual funds.

Some western groups are seeking alternatives. Merrill Lynch, for example, recently became the first non-Japanese group to develop its own brokerage outlets, by buying 30 outlets of the



Fidelity Investments sales counter at Sanwa Bank, Shinjuku, Tokyo: a fresh concept in Japan

failed Yamaichi broker. Fidelity is hoping to tap into telephone, or even internet sales.

But most other western groups believe that developing independent distribution channels is not feasible. And although some, such as Smith Barney or Putnam, are establishing partnerships

and joint ventures with Japanese as an alternative tactic, these alliances create huge management challenges.

However, the second problem is marketing. Mutual funds are currently a concept that many Japanese regard with unease. This is partly because many house-

holds lost money after the collapse of the 1990s stock market bubble. But Japanese brokers also traditionally tended to encourage consumers to "churn" mutual funds as soon as they yielded profits, rather than hold them for a long time.

As a result, they are regarded more like gambling

tools than investments.

Western groups are trying to change this perception. Commerz International Asset Management, the fund management arm of the German banking group, for example, is distributing a CD-ROM cartoon, which uses simple parables to explain unfamiliar concepts such as diversification. "We explain that portfolio investment is like a garden. You need to plant different vegetables so that you can still have a good harvest even if one goes rotten," says an official.

Getting this message across will probably take considerable time. And in the interim, most companies expect to see steady, rather than explosive growth. But in a market the size of Japan's, simply a 10 per cent annual growth in the sector could generate some lucrative business for both Japanese and western groups.

"We are ready to lose money for 10 years," says Felix Pang, a general manager of Fidelity. "But I think there is the biggest opportunity for 30 years for foreign financial institutions to reach this market. It's a very exciting opportunity if you look at the long term."

CORPORATE PENSION FUNDS • by Gillian Tett

Reforms get under way

Western groups are making some important inroads in Japan's pension industry

Takahiko Okada, president of the pension fund at Fubitsu, Japan's largest computer manufacturer, chooses his words with care.

"Our company has taken a clear decision to take our pension money away from asset managers which do not offer high returns," he says solemnly. "And we will give it to companies which do."

Coming from a western company, the comment might seem commonplace. In Japan, though, it points to a striking shift now under way.

For as Big Bang looms a growing number of companies are now trying to introduce changes in the way they run their pensions. And although western groups have traditionally been almost entirely excluded from the sector, the pension industry is now becoming one area where western groups are making some of the most striking inroads in Japan's financial world.

Fubitsu is a case in point. It used to only use Japanese companies to manage its pension money. But now, foreign groups such as Schroders, Mercury Asset Management, JP Morgan and Credit Suisse manage 20 per cent of Fubitsu's ¥500bn fund. "We think western groups can sometimes be more independent," Mr Okada says.

The tale is echoed across the sector. Last March, foreign groups had a 5.9 per cent share of the pension market, according to Hiroshi Nakagawa, managing director of Intersec, a pension consultant. By September it had risen to 7.6 per cent. And foreign groups are now winning 35 per cent of all

new pension money being given to trust banks and investment advisers.

George Curuby, a consultant, forecasts from his analysis that the assets managed by foreigners could double to ¥70bn in the next seven years. "It is clear that Japan is at the beginning stage of a gold rush for the world's investment management community," he says.

At first glance this seems a compelling sign that Big Bang is ushering in real change. But the tale - like so much in Big Bang - is complex. For although the shift in the pension market is often described as part of "Big Bang", it is not being driven by forthcoming regulatory reforms alone. Instead, it owes more to regulatory changes that have already occurred, and longer term pressures in the pension industry.

Until recently in Japan, corporate pension funds were managed by two groups: life insurance companies and trust banks. These were generally selected not according to performance, but traditional business ties, centred around the *keiretsu* business families.

But this pattern has come under growing strain. The ageing population has left many corporate pension funds seriously underfunded. And the rates of return offered by Japanese life insurance companies and trust banks have been falling.

This is partly because Japanese investment instruments have been performing badly in recent years. But many trust banks and life insurance groups have also been using relatively unsophisticated fund management techniques. They are also handicapped by their traditional business ties. Life insurance groups, for example, are often reluctant to sell shares in "related" com-

panies, irrespective of how badly they perform.

Given this, some companies have been looking for alternative fund managers. But until recently they were prevented from making too radical a switch because of a myriad regulations, such as the so-called "5-3-3-2" rule. This stipulated that more than 50 per cent of pension funds had to be invested in principal-secured safe assets, less than 30 per cent in securities, less than 30 per cent in foreign assets and 20 per cent in real estate.

But many of these regulations have been recently lifted. In 1996, for example, the government relaxed the 5-3-3-2 rule. Before this, it permitted companies to place some money with "investment advisers" (a third type of fund manager which generally offers a more specialist mandate than the life insurance or trust bank groups.)

Last autumn it announced that IAs could manage "tax qualified" pension funds for the first time. Next year, IAs will be allowed to manage accounts in a single block, which will reduce their costs. And although Japanese companies cannot place more than 50 per cent of their money with IAs at present, this rule is also likely to be lifted soon.

These changes have meant that some Japanese companies are now shifting their money to better performing fund managers - and, above all, to the more specialist mandates that IAs can offer.

This has benefited some Japanese companies, such as Nomura and Industrial Bank of Japan, who are the largest IAs. But it has also ushered in a business surge for foreign groups, who now account for 33 per cent of the IA sector. One reason is that many Japanese companies now want to increase their overseas portfolios, and consider that foreign groups

have better expertise than Japanese in this. But some companies also want to employ the specialist, research-based service which western groups offer - even for Japanese investments.

Fubitsu, for example, uses Schroders, the UK fund manager, to manage part of its Japanese equities. And Sony, the electronics group, also uses some non-Japanese companies to manage Japanese funds, after it decided last year that it wanted to move to a more active style of management. Indeed, foreign companies now manage half of its pension money, after Sony recently withdrew its funds from life insurance groups.

Masakazu Arikawa, general manager of Sony's finance division says: "Even though some life insurance companies have good returns they didn't meet our requirements."

Whether the rise in the western market share can continue at this pace is unclear. If overseas markets experience a slump, the excitement about non-Japanese investments could ease. And cultural obstacles to using western firms still remain: in spite of the bold stances taken by Sony and Fubitsu, most companies are still reluctant to cut *keiretsu* ties. Furthermore, some Japanese companies are also scrambling to compete better with western groups.

But catching up with western techniques will not be easy for many Japanese companies. And in the meantime, Fubitsu itself sees little sign that the trend to use foreign groups will change. "I think one third of the Japanese asset managers have a chance of reaching the level (we want)," says Mr Okada. "But unfortunately two thirds of the Japanese companies do not."

*Japan's Pension Market to 2005, ISI Publications (852) 2877 3417, 3299.



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6 JAPAN'S FINANCIAL REVOLUTION

REGULATION • by Gillian Tett

Crucial issue will determine the success of Big Bang

Investors need to see clear laws, corporate accounts and bank checks - they can believe in

This summer, 300 bureaucrats at Japan's Ministry of Finance will experience a subtle job change. Instead of working in the MoF's Tokyo headquarters, they will move into another building next door to staff a newly created "Financial Supervision Agency".

The move is intended to show that Japan is reforming its system of financial supervision as part of Big Bang. The crucial question now is whether it will work. For although Big Bang is billed as a project about deregulation, its success now partly depends instead on regulation. Above all, with-

out rapid reforms to the regulatory system, there is a real risk that the entire Big Bang project could fail.

The problem is acute because the system used to run Japan's financial sector is strikingly different from that in modern Anglo-Saxon markets.

Indeed, just how different has become clear to any onlooker in a series of corruption scandals. First, last summer, it emerged that the country's biggest four brokers had been quietly paying *sokaiya* - corporate racketeers.

Then it transpired that several large banks had been providing lavish entertainment - including wine and dining, golf, and trips to sex bars - to MoF officials who were supposed to be regulating them. It also emerged that several banks and brokers had also been using similar lavish entertainment

to win eurobond contracts.

And this month another scandal tumbled out: an official at the Bank of Japan was arrested for allegedly receiving favours in the form of lavish wine and dining from banks in exchange for market-sensitive information.

To western eyes, this makes sordid reading. But the crucial issue is that these are not isolated incidents of individual crime. Such practices have been endemic in Japan for decades - and reflect a pattern of corporate behaviour that is profoundly different from that in countries such as the US.

On paper, for example, Japan has all the trappings of a modern capitalist system. There are accountants, shareholders, lawyers and laws. There is also a system of government supervision which produces regular

reports on the banks and brokers.

But these institutions have often played a different role from those in Anglo-Saxon countries. Accountants, for example, have been deeply entwined with the companies they monitored. Independent shareholders had little power. Law suits were rarely used to settle business disputes.

Meanwhile, the government itself has appeared more akin to a "puppet-master" pulling strings, than a neutral "umpire" overseeing the financial game.

The key reason was that Japan used a system known as "administrative guidance" to decide what companies could do. In this, decisions were taken not according to clearly defined laws, but case-by-case informal consultation.

Many Japanese have argued that the system

worked well enough in the past. But it is fundamentally at odds with the avowed Big Bang goal to create "fair, free and global" financial markets. "Administrative guidance" is apt to stifle financial innovation; it blatantly discriminates against companies which do not have close personal links with bureaucrats.

But the most pernicious problem is that the system does not build the market confidence that a globally competitive market requires. What international investors need to see, in other words, are clear laws, corporate accounts and bank inspections that they can believe in.

Can Japan produce this? The government insists it wants to try, and had included some reforms within the Big Bang timetable. This summer, for example, the FSA will

assume ultimate responsibility for regulating the banks and brokers. This step will effectively remove these powers from the MoF (just as supervision has been separated from the Treasury in the US).

This spring, a new system of "prompt corrective action" will be introduced for internationally operating banks, which will require the banks to adhere to tighter capital adequacy criteria. The FSA will have the right to order a bank to suspend its business if it fails to meet the standards.

A similar system will be introduced for brokers: the FSA will be able to close down brokers which do not meet tightened capital adequacy standards of 100 per cent.

These steps could, in theory, go some way to improving the situation. But they do not solve the entire prob-

lem. It remains crucially unclear, for example, exactly how the new FSA will operate. And although it is assumed that the majority of the 300-odd employees will be taken from the MoF, this appears a pitifully small number to cope with the regulatory problems thrown up by Big Bang.

Another problem is that Japan has a severe shortage of lawyers and accountants who can impose new laws or deliver independent, credible accounts. At present only about 600 lawyers actually graduate each year. Japan's law society has recently agreed to double this figure over the next few years but it has blocked suggestions that foreign companies should be allowed to set up competing businesses in Japan.

The biggest problem remains the most intangible: the cultural attitude. Unless

the MoF can master a new rule - as a neutral "umpire" - rather than "puppet master" - it will never be able to create a climate of open, fair competition. Similarly, unless Japanese companies themselves can accept that they need to be transparent in front of shareholders, it will be difficult to win investor confidence, irrespective of the new FSA.

The eruption of the recent corporate scandals may be one sign that attitudes are changing. But the scale of reform now needed is huge. "The success of Big Bang will not lie in the creation of new laws... but a transparent and accountable regulatory process," argues Peter del Vecchio, a lawyer with White and Case, the US law group. "Arbitrary and non-transparent administration is capable of completely negating the benefits of Big Bang."

OSAKA • by Vincent Boland

Stock exchange has taken steps to protect its position

Developments such as J-Net should allow the OSE to hone its competitive status

Nowhere are Tokyo's preparations for Big Bang being watched more closely than in Osaka. Japan's other financial centre and one that is very keen to maintain its own position as the country's leading derivatives trading centre after deregulation takes root.

At the Osaka Stock Exchange (OSE), and among the city's large number of securities firms, there is a general feeling that they were the first to accept that something like Big Bang would have to happen one day.

Market participants say they have a lot to gain from liberalisation, especially because it will greatly expand the market for new products, an area where Osaka already claims to be

more competitive than Tokyo.

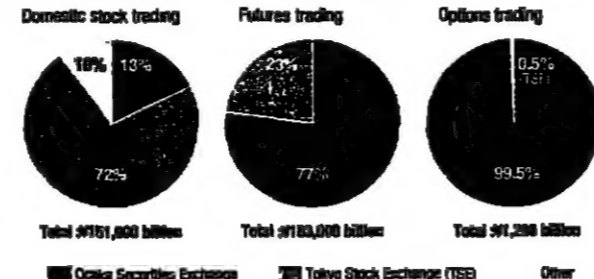
"The bigger the bang, the better," says Takuo Noguchi, senior executive director of the Osaka Securities Exchange. "The OSE has in the past worked for widespread changes in the way the markets are run, and will continue to do so."

Self-interest is the motivation. According to Goro Tatsumi, chairman of Koei Securities and president of the Osaka securities industry federation, the OSE handled 50 per cent of all Japanese securities transactions until the second world war, but then its share began to decline rapidly.

Today, the exchange has about one-fifth of the business, although it dominates in futures and derivatives trading.

Mr Tatsumi says the aim now should be to capitalise on the city's strengths in futures trading, which he claims was invented there 250 years ago with the development of a market for rice.

Osaka Securities Exchange's current position



If the politicians in Tokyo and the country's business leaders can get their act together and deregulation proceeds as planned, "Osaka can become a global market as far as futures and derivatives trading is concerned," he says.

The OSE has already taken steps to protect and enhance its position, although Mr Noguchi says that what really matters in Big Bang is not the number or range of new products that can be developed in a

deregulated environment but the kind of trading systems that are put in place to trade them.

Change is already evident at the OSE, with its banks of empty trading points and sparse floor trading. The advent of electronic trading means the cavernous OSE chamber, dating from the 1930s, is rapidly becoming redundant. Equity and equity options trading were computerised at the end of last year. Plans are now afoot to introduce new index

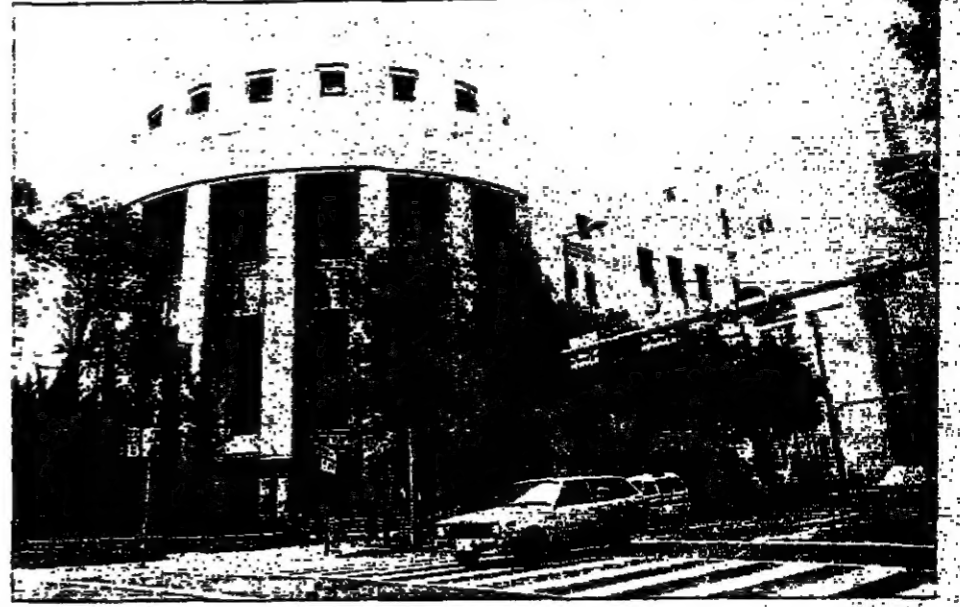
derivatives in the next couple of months in the financial, consumer and high-tech sectors.

But the rise of other exchanges in the Asia-Pacific region in the past few years, and the bursting of Japan's stock market bubble in the early 1990s, have taken their toll. OSE trading volume for the Nikkei 225 futures contract, the market's most liquid and important instrument, is erratic. It reached ¥137,000bn in 1997, but in 1991, for example, trading volume in the contract reached ¥536,700bn.

At the same time, trading volume in the Nikkei 225 futures contract has been rising on Simex, although it remains well below the OSE. Nevertheless, competition between these two exchanges is almost certain to increase after Big Bang, bankers and securities market professionals agree.

To counter this threat, the OSE is courting exchanges abroad for two-way co-operation. Alliances with the Chicago Board Options Exchange and the Chicago Board of Trade and with the London International Financial Futures and Options Exchange "will be realised in some form this year," Mr Noguchi says, though he declines to elaborate.

More important, from its point of view, is the completion of its new J-Net electronic trading network system now under development, which will be used to negotiate the details of a contract for cross-trading on the



The Osaka Stock Exchange dominates in futures and derivatives trading

OSE's computer trading market. Mr Noguchi says the exchange hopes to start testing the J-Net in September, while the system is due to be fully implemented and working by the end of the year.

For Osaka-based financiers, the hope is that J-Net will enable the OSE to secure its competitive position with Tokyo in futures and derivatives trading and win more cash business. Mr Noguchi insists, however, that the Osaka-Tokyo rivalry should not cloud the larger issue of where Big Bang will leave the country on the global financial map. "To outsiders, the OSE and the TSE appear to be competing, and there is competi-

tion between us. The more important issue is not which exchange will win, but how Japan will be positioned in global financial markets," he says.

The development of the country's financial markets has created deficiencies but also has many advantages.

"There are deficiencies in our financial markets, but both government and the industry are now aware of them," he says. "For the Japanese financial industry, its future depends on how much of the legacy will be discarded while keeping the good bits. Change offers a chance for everybody, but it will be a tragedy for those who can't keep up."

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A STRATEGY FOR WESTERNERS • by Gillian Tett

Wave of corporate flirting

Political pressures could cool the innovative ardour of western white knights

Take a glance at Tokyo's financial world this spring, and it might appear that a giant dating game is under way. For over the past year a new wave of corporate flirting has emerged between Japanese and western firms.

There have been some fully fledged marriages: this summer, for example, Swiss Bank Corporation is to set up three joint ventures with the Long Term Credit Bank of Japan, the first such concluded by a western bank in Japan.

There have been many other, much more loose alliances: Putnam, the US mutual fund, to cite another example, has recently agreed to collaborate with Nippon Life, the largest Japanese life insurance group, in asset management.

And though such alliances are not entirely new, the trend highlights two key points about Big Bang.

One is that the financial changes are now attracting unprecedented interest from western groups. The second is that westerners wanting to enter Japan's markets now face some difficult strategic decisions.

The problem is as follows: western companies have financial skills which Japanese markets lack. Meanwhile, Japanese companies have well-established corporate and retail distribution networks which the western groups do not possess.

Some western companies have decided to solve this by renting distribution space, or by building it themselves. Citibank, the US group, for

example, has built its own retail banking business; JP Morgan is taking an independent path in investment banking. But this is expensive and time-consuming: it has taken Citibank about a decade to develop its own network, for example.

One short cut might be for a western group to buy a Japanese company. This, after all, was precisely what occurred after the 1986 UK Big Bang, when foreigners acquired many British merchant banks. And last year it was widely muttered in Tokyo that this might be about to occur in Japan as well.

But this seems unlikely. A few purchases have occurred: GE Capital, the US financial services company, for example, has bought two small consumer finance groups. But these remain exceptions.

This is partly because Japan has limited tradition of mergers and acquisitions. But it is also because potential purchase candidates are limited.

Successful financial groups are extremely expensive. But the poor performance - and cheaper - companies are usually weighed down by bad loans. Judging the scale of liabilities is difficult, because Japanese accounting practices are so opaque. And even if a purchase can be agreed, a further problem is that Japan's rigid labour laws make it costly to cut staff.

So where does this leave the westerners? Some have recently produced some innovative solutions. Merrill Lynch, the US investment bank, for example, has wanted to develop a brokerage network for years. However, it has been reluctant to buy an entire Japanese company or start from scratch.

The collapse of Yamaichi Securities, Japan's fourth largest broker, last November offered it another option: picking the assets it actually wanted from Yamaichi without buying the entire group. Earlier this year it announced that it would create a company capitalised at about \$300m by purchasing 30 of Yamaichi's brokerage outlets, and hiring some 2,000 of its staff.

GE Capital has used a tactic similar in spirit, albeit different in form. It recently announced that it would inject ¥72bn into a "joint venture" with Toho Mutual, the ailing life insurance company. This will control all of Toho's new business, and acquire 7,000 of its 10,000 staff. And GE Capital will have 90 per cent control over the group - a state of affairs that Toho only accepted because of its own dire financial state.

Such tactics seem canny and more examples may soon emerge. The Ministry of Finance is eager to find "white knights" for the hordes of weak banks, brokers or life insurance groups that now exist.

But such tactics also carry risks: western "white knights" could face political pressure to provide additional support at a later date. GE Capital, for example, insists that it does not have any legal exposure to Toho Mutual's old, troubled, business. However some Japanese life insurance groups want the US company to contribute funds to help the rest of the life insurance sector.

Another option is a more equal partnership or alliance. SBC's alliance with LTCB, for example, involves 50-50 ownership, although it will be staffed mostly by the western side (partly because

SBC is itself currently merging with Union Bank of Switzerland). And there are many looser alliances: Nikko Securities and Smith Barney are jointly developing "wrap accounts"; Bankers Trust, the US group, is working with Nippon Credit Bank in securitisation; Goldman Sachs is collaborating with Yasuda Trust bank in the property business.

But alliances also carry problems. Managing a joint venture - or even a loose alliance - is difficult in Japan because of cross-cultural differences. And Big Bang has created an added problem: some Japanese businessmen suspect that the western groups only want alliances now to "pinch" good clients ahead of reform: westerners suspect the Japanese in turn are now trying to "pinch" western technology and skills.

Those actually involved in joint ventures insist they will work. Steven Spiegel, senior managing director of Putnam, says: "The dangers have entered our mind, but remain manageable. We are very happy about how the partnership (with Nippon Life) is working."

Or as Katsunobu Onogi, president of LTCB, said recently about his deal with SBC: "Working together means we are stronger. We complement each other." And if these alliances do develop smoothly, they could indeed offer a formidable platform with which to cope with financial reform. But in the short term, there will be some intriguing cultural and management challenges.

Westerners wanting to gain a strong presence in the Japanese market, in other words, are unlikely to find any easy short cuts.